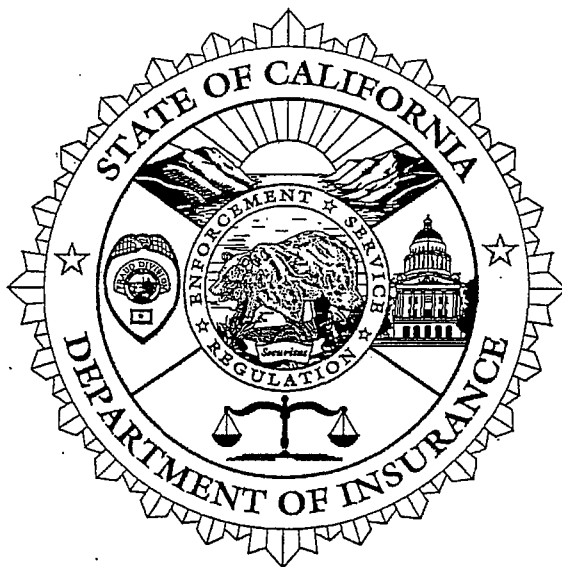


**REPORT OF EXAMINATION OF THE
RATING AND UNDERWRITING PRACTICES OF THE
MERCURY INSURANCE COMPANIES**

AS OF JULY 2, 1998

(WITH ADDENDUM)



Conducted by Associate Insurance Rate Analysts:

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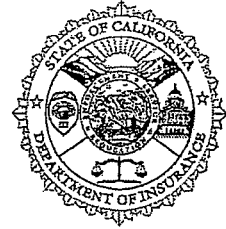
TABLE OF CONTENTS

	<u>PAGE</u>
SALUTATION.....	1
SCOPE OF THE EXAMINATION.....	3
ORGANIZATION AND OPERATION.....	4
METHOD OF DOING BUSINESS.....	4
AUTHORIZED LINES OF BUSINESS.....	6
DISTRIBUTION OF WRITTEN PREMIUMS.....	7
LOSS EXPERIENCE STUDIES.....	8
ADVERTISING MATERIALS.....	11
COMPLAINT TREND ANALYSIS.....	12
POLICY SAMPLE REVIEWED.....	13
EXAM RESULTS SUMMARY TABLE.....	14
HIGH ERROR RATIO.....	14
COMMISSION LEVEL STUDY.....	16
HOMEOWNERS MULTIPLE PERIL.....	17
ADOPTED RULES, RATES, AND FORMS.....	17
Personal Umbrella Program.....	25
APPLICATION OF RULES, RATES, AND FORMS.....	28
Declined, Canceled, or Non-Renewed Policies.....	28
PRIVATE PASSENGER AUTOMOBILE.....	31
Underwriting Results.....	31
VOLUNTARY PERSONAL AUTOMOBILE PROGRAM.....	32
ADOPTED RULES, RATES, AND FORMS.....	32
Mechanical Breakdown Program.....	59
APPLICATION OF RULES, RATES, AND FORMS.....	59
Declined, Canceled, or Non-Renewed Policies.....	59
Description of Errors.....	67

CALIFORNIA AUTOMOBILE ASSIGNED RISK PROGRAM.....	69
ADOPTED RULES, RATES, AND FORMS	69
APPLICATION OF RULES, RATES, AND FORMS	70
Declined, Canceled, or Non-Renewed Policies	71
Description of Errors.....	71
COMMERCIAL AUTOMOBILE	72
ADOPTED RULES, RATES, AND FORMS	72
APPLICATION OF RULES, RATES, AND FORMS	80
Declined, Canceled, or Non-Renewed Policies	80
Description of Errors.....	82
COMMERCIAL MULTIPLE PERIL	84
Underwriting Results	84
COMMERCIAL MULTIPLE PERIL PROGRAMS	85
ADOPTED RULES, RATES, AND FORMS	85
APPLICATION OF RULES, RATES, AND FORMS	94
Declined, Canceled, and Non-Renewed Policies.....	95
Description of Errors.....	96
SUMMARY OF MAJOR EXAMINATION CRITICISMS.....	98
Method of Doing Business.....	98
Homeowners Multiple Peril Program	98
Personal Umbrella Program	101
Voluntary Personal Automobile Program.....	102
California Automobile Assigned Risk Program	109
Commercial Automobile Program.....	109
Commercial Multiple Peril Programs	111
CERTIFICATION.....	113
ADDENDUM	114

DEPARTMENT OF INSURANCE

Field Rating and Underwriting Bureau
300 S. Spring Street, 11th Floor
Los Angeles, CA 90013
(213) 346-6770



October 20, 2000

The Honorable Harry W. Low
Insurance Commissioner
State of California
45 Fremont Street
San Francisco, California 94105

Honorable Commissioner:

Pursuant to instructions, an examination was made of the rating and underwriting practices and procedures in California of the Mercury Insurance Companies, consisting of:

MERCURY INSURANCE COMPANY (NAIC #27553),

MERCURY CASUALTY COMPANY (NAIC #11908),

CALIFORNIA AUTOMOBILE INSURANCE COMPANY (NAIC #38342),

CALIFORNIA GENERAL UNDERWRITERS INSURANCE COMPANY (NAIC #31046),

and

AMERICAN MERCURY INSURANCE COMPANY (NAIC #16810)

Hereinafter referred to collectively as Mercury (Mercury Insurance Companies), or individually as MIC (Mercury Insurance Company), MCC (Mercury Casualty Company), CAIC (California Automobile Insurance Company), CGUIC (California General Underwriters Insurance Company), and AMIC (American Mercury Insurance Company).

CGUIC and AMIC were exempted from the examination's policy file review. CGUIC has no California premium earnings, and AMIC is currently generating less than \$2,500,000 in premiums, which is not enough to warrant a policy file review.

SCOPE OF THE EXAMINATION

This examination covered the underwriting and rating practices applied by Mercury to its homeowners multiple peril, personal automobile, commercial multiple peril, and commercial automobile insurance programs during the period January 1, 1995 to July 2, 1998. The examination was made to discover, in general, if the operating procedures adopted by Mercury for these programs conform to provisions of the California Insurance Code (CIC) and the California Code of Regulations (CCR).

To accomplish the foregoing, the examination included:

1. A review of the rates, rating plans, forms, and underwriting rules made or adopted by Mercury for use in California, including a review of records of data, statistics, or information maintained by Mercury in support of, or relating to, such rates, forms, and rules.
2. A review of the application of such rates, forms, and rules by means of an examination of policy files and related records.

The examination was primarily conducted at Mercury's branch office in Brea, California. Brief visits were also made to Mercury's branch offices in Westlake and Riverside, California, for the purpose of performing personal automobile policy file reviews.

ORGANIZATION AND OPERATION

METHOD OF DOING BUSINESS

Mercury markets its insurance products in both Southern and Northern California through the sales offices of 817 members of the American Agency System. Approximately 12% of these insurance producers have been appointed by Mercury as independent agents. The remaining producers contract with Mercury as insurance brokers.

The brokers are subject to substantially the same direction and control from Mercury as are the agents. Both the agents and the brokers use the same rating and underwriting manuals and follow the same application submission requirements. The agents and brokers also have similar written contracts with Mercury. Moreover, Mercury will not accept applications from any broker who does not have a contract with Mercury.

From a marketing standpoint, Mercury does not make any significant distinction between the brokers and the agents. Mercury represents the brokers as "independent agents" in its print and radio advertisements and has requested that the brokers rebate their broker fees when handling business that they know has been generated by Mercury rate comparison advertisements. Moreover, the brokers use the same Mercury application forms as do the agents and have been invested with the same 7-day binding authority. The brokers are also authorized by Mercury to quote premiums and issue financial responsibility certificates on its behalf.

The extent of Mercury's direction and control over the brokers in the submission of applications, Mercury's representation of the brokers as independent agents, and the binding authority that Mercury has invested in the brokers are altogether inconsistent with the CIC Section 1623 brokerage definition. The brokers are therefore held to be operating as de facto

agents under CIC Section 1621.

Mercury's misrepresentation of the brokers has resulted in at least three violations of the insurance statutes. A description of these violations is provided below.

1) The brokers are charging broker fees for rendering the same services and coverage to Mercury's insureds that the agents provide. This being the case, insureds who purchase insurance coverage through the brokers are likely to pay more for their insurance policies than they would have had they bought their policies through agents. Given that the brokers are operating as de facto agents under CIC Section 1621, the cost differential that is created by the added broker fees is inequitable to insureds and violates CIC Section 1861.05(a).

2) Mercury's print and radio advertisements advise the reader/listener that he can obtain a quote from one of Mercury's "independent agents." Mercury's portrayal of the producers as independent agents is misleading given that a) Mercury has a brokerage contract with most of the producers, and b) the brokers can charge broker fees for the business that is generated from all non-rate comparison advertisements. When the brokers charge broker fees to individuals who have been misled by Mercury advertisements into thinking that they would be transacting business with independent agents, the misrepresentations translate into violations of CIC Section 790.03(b).

3) Mercury has not filed notices of appointment with the California Insurance Department (CDI) for the brokers. Given that the brokers are operating as de facto agents, Mercury's failure to file the appointments is a violation of CIC Section 1704(a).

These violations will be referred to the CDI's Legal Division for review.

AUTHORIZED LINES OF BUSINESS

The Mercury Insurance Companies are authorized by the CDI to transact the classes of business denoted below:

	<u>MIC</u>	<u>MCC</u>	<u>CAIC</u>	<u>CGUIC</u>	<u>AMIC</u>
1. Life					
2. Fire	X	X	X		X
3. Marine	X	X	X		X
4. Title					
5. Surety	X	X	X		X
6. Disability	X	X	X		
7. Plate Glass	X	X	X		X
8. Liability	X	X	X	X	X
9. Workers' Compensation					
10. Common Carrier Liability	X		X		X
11. Boiler and Machinery	X		X		
12. Burglary	X	X	X		X
13. Credit	X		X		
14. Sprinkler	X	X	X		
15. Team and Vehicle	X		X		X
16. Automobile	X	X	X	X	X
17. Mortgage					
18. Aircraft	X		X		
19. Mortgage Guaranty					
19.6 Legal Insurance					
20. Miscellaneous	X	X	X		X

DISTRIBUTION OF WRITTEN PREMIUMS

The following tables show the direct written premiums for the Mercury Insurance Companies by line of business for 1997. The figures are derived from the Statutory Pages 14 of the 1997 Annual Statements that Mercury filed with the Insurance Commissioner. The table for CGUIC has been omitted because the company did not write any business in 1997.

Distribution by Line of California Direct Premiums Written in 1997

<u>Lines of Business</u>	<u>MIC</u>		<u>MCC</u>	
	<u>Amount Written</u>	<u>% of the Total</u>	<u>Amount Written</u>	<u>% of the Total</u>
Fire and Allied Lines	\$ 0	0.0%	\$ 756,531	0.3%
Homeowners Multi Peril	0	0.0	8,741,761	3.1
Commercial Multi Peril	0	0.0	8,882,289	3.2
Earthquake	0	0.0	793,793	0.3
Other Liability	0	0.0	732,670	0.2
Priv Pass Auto Liability	471,160,520	67.7	150,024,469	53.4
Priv Pass Auto Phys Dmg	234,743,243	33.3	74,914,514	26.7
Commercial Auto Liability	0	0.0	28,177,543	10.0
Commercial Auto Phys Dmg	0	0.0	7,965,029	2.8
Totals	<u>\$705,903,763</u>	<u>100.0%</u>	<u>\$280,988,599</u>	<u>100.0%</u>

<u>Lines of Business</u>	<u>CAIC</u>		<u>AMIC</u>	
	<u>Amount Written</u>	<u>% of the Total</u>	<u>Amount Written</u>	<u>% of the Total</u>
Fire and Allied Lines	\$ 0	0.0%	\$ 0	0.0%
Homeowners Multi Peril	0	0.0	0	0.0
Commercial Multi Peril	0	0.0	0	0.0
Earthquake	0	0.0	0	0.0
Other Liability	0	0.0	0	0.0
Priv Pass Auto Liability	9,259,516	100.0	0	0.0
Priv Pass Auto Phys Dmg*	2,187	0.0	2,285,699	100.0
Commercial Auto Liability	0	0.0	0	0.0
Commercial Auto Phys Dmg	0	0.0	0	0.0
Totals	<u>\$ 9,261,703</u>	<u>100.0%</u>	<u>\$ 2,285,699</u>	<u>100.0%</u>

* AMIC's private passenger automobile physical damage premiums are derived from its Mechanical Breakdown Program.

LOSS EXPERIENCE STUDIES

The table shown below displays the consolidated California adjusted loss ratios for the Mercury Insurance Companies, by line of business, for calendar years 1995, 1996, and 1997, combined, based on data from the Statutory Pages 14 of the Annual Statements on file with the CDI.

The tables shown on the following two pages display each company's California adjusted loss ratios for calendar years 1995, 1996, and 1997, combined. AMIC's table shows adjusted loss ratios for 1997, only, because the Mercury Insurance Companies acquired AMIC in January of that year. The table for CGUIC has been omitted because CGUIC did not generate any premiums in 1995, 1996, or 1997.

When pertinent, references will be made in the report to the loss ratios displayed in these tables.

MERCURY INSURANCE COMPANIES, CONSOLIDATED
Loss Experience by Line
For the Years 1995, 1996, and 1997, Combined

	(1)	(2)	(3)
	Direct	Direct	Loss
	Premiums	Losses	Ratios
<u>Lines of Coverage</u>	<u>Earned</u>	<u>Incurred</u>	<u>(%)</u>
Fire and Allied Lines	\$ 2,008,091	\$ 701,433	34.9%
Homeowners Multi Peril	17,354,576	7,440,269	42.9
Commercial Multi Peril	25,507,327	7,840,065	30.7
Earthquake	3,003,450	3,018,436	100.5
Other Liability	1,107,597	72,651	6.6
Priv Pass Auto Liability	1,471,839,288	671,932,125	45.7
Priv Pass Auto Phys Dmg	676,830,714	469,441,071	69.4
Commercial Auto Liability	72,132,128	30,283,259	42.0
Commercial Auto Phys Dmg	19,425,683	8,294,144	42.7
Totals	<u>\$2,289,208,854</u>	<u>\$1,199,023,453</u>	<u>52.4%</u>

MERCURY INSURANCE COMPANY
Loss Experience by Line
For the Years 1995, 1996, and 1997, Combined

<u>Lines of Coverage</u>	(1) Direct Premiums <u>Earned</u>	(2) Direct Losses <u>Incurred</u>	(3) Loss Ratios <u>(%)</u>
Fire and Allied Lines	\$ 0	\$ 0	0.0%
Homeowners Multi Peril	0	0	0.0
Commercial Multi Peril	0	0	0.0
Earthquake	0	0	0.0
Other Liability	0	0	0.0
Priv Pass Auto Liability	1,066,130,227	472,204,388	44.3
Priv Pass Auto Phys Dmg	494,139,304	339,858,713	68.8
Commercial Auto Liability	0	0	0.0
Commercial Auto Phys Dmg	0	0	0.0
Totals	<u>\$1,560,269,531</u>	<u>\$ 812,063,101</u>	<u>52.0%</u>

MERCURY CASUALTY COMPANY
Loss Experience by Line
For the Years 1995, 1996, and 1997, Combined

<u>Lines of Coverage</u>	(1) Direct Premiums <u>Earned</u>	(2) Direct Losses <u>Incurred</u>	(3) Loss Ratios <u>(%)</u>
Fire and Allied Lines	\$ 2,008,091	\$ 701,433	34.9%
Homeowners Multi Peril	17,354,576	7,440,269	42.9
Commercial Multi Peril	25,507,327	7,840,065	30.7
Earthquake	3,003,450	3,018,436	100.5
Other Liability	1,107,597	72,651	6.6
Priv Pass Auto Liability	363,621,975	182,754,254	50.3
Priv Pass Auto Phys Dmg	170,000,605	121,831,756	71.7
Commercial Auto Liability	72,132,128	30,283,259	42.0
Commercial Auto Phys Dmg	19,425,683	8,294,144	42.7
Totals	<u>\$ 674,161,432</u>	<u>\$ 362,236,267</u>	<u>53.7%</u>

CALIFORNIA AUTOMOBILE INSURANCE COMPANY
Loss Experience by Line
For the Years 1995, 1996, and 1997, Combined

<u>Lines of Coverage</u>	(1) Direct Premiums Earned	(2) Direct Losses Incurred	(3) Loss Ratios (%)
Fire and Allied Lines	\$ 0	\$ 0	0.0%
Homeowners Multi Peril	0	0	0.0
Commercial Multi Peril	0	0	0.0
Earthquake	0	0	0.0
Other Liability	0	0	0.0
Priv Pass Auto Liability	42,087,086	16,973,483	40.3
Priv Pass Auto Phys Dmg	10,681,122	6,225,180	58.3
Commercial Auto Liability	0	0	0.0
Commercial Auto Phys Dmg	0	0	0.0
Totals	<u>\$ 52,768,208</u>	<u>\$ 23,198,663</u>	<u>44.0%</u>

AMERICAN MERCURY INSURANCE COMPANY
Loss Experience by Line
For the Year 1997

<u>Lines of Coverage</u>	(1) Direct Premiums Earned	(2) Direct Losses Incurred	(3) Loss Ratios (%)
Fire and Allied Lines	\$ 0	\$ 0	0.0%
Homeowners Multi Peril	0	0	0.0
Commercial Multi Peril	0	0	0.0
Earthquake	0	0	0.0
Other Liability	0	0	0.0
Priv Pass Auto Liability	0	0	0.0
Priv Pass Auto Phys Dmg*	2,009,683	1,525,422	75.9
Commercial Auto Liability	0	0	0.0
Commercial Auto Phys Dmg	0	0	0.0
Totals	<u>\$ 2,009,683</u>	<u>\$ 1,525,422</u>	<u>75.9%</u>

- These premiums are derived from AMIC's Mechanical Breakdown Program

ADVERTISING MATERIALS

Mercury has issued or approved numerous advertisements that encourage people to obtain a quote from one of Mercury's "independent agents." Some of these advertisements identify specific producers by name. Others reference the producers representing Mercury collectively as a group. The examination showed, however, that most of the producers who are mentioned in the advertisements, either specifically by name or collectively as a group, contract with Mercury as brokers -- not as agents.

Because appointed agents can not lawfully charge broker fees, the advertisements' reference to Mercury's producers as "independent agents" implies that respondents will not be charged broker fees if they purchase insurance coverage from Mercury. However, this is not always the case. Mercury has requested that the brokers rebate their broker fees when respondents are referred to them via special 800 and 888 telephone numbers that Mercury has established for certain rate comparison advertisements, or when respondents mention that they are responding to a Mercury rate comparison advertisement. But, Mercury has not requested that the brokers rebate their broker fees for any other advertisements. In other words, the brokers are under no obligation to rebate their broker fees if respondents contact them directly and do not mention that they are responding to a Mercury rate comparison advertisement.

The advertisements' portrayal of the brokers as independent agents violates CIC Section 790.03(b) when the brokers charge broker fees for the business that is generated from the advertisements.

This violation will be referred to the CDI Legal Division for review.

COMPLAINT TREND ANALYSIS

The examination included a review of the 142 underwriting and rating-related complaints that MIC's and MCC's customers registered with the CDI over an eleven month period beginning January 1, 1997. Sixteen (11%) of these complaints concerned MIC's and MCC's upward adjustments of personal automobile insurance premiums at policy issuance.

A study was done of MIC's and MCC's premium adjustment procedures. It was found that the producers sometimes included certain discounts in their quotes before they had obtained the documentation required to substantiate these credits. The producers then submitted the applications, minus the supporting documentation, to MIC and MCC. Upon receipt of some of these applications, the companies immediately uprated the premiums on the basis that they had not received the supporting documentation.

MIC and MCC are ultimately responsible under CIC Section 1861.05(a) for ensuring that the premium quotation service that they provide to the public is relatively free of error. If producers submit applications without the documentation needed to substantiate the discounts that they have included in the premium quotations, then MIC and MCC need to give the insureds sufficient time to produce these documents before adjusting their premiums.

MIC and MCC have not proposed any solutions for minimizing the incidence of upward premium adjustments. This matter has therefore been referred to the CDI Legal Division for review.

The remainder of the complaints did not indicate any error trends. However, specific attention was paid during the rating and underwriting examination to the additional issues mentioned in the complaints.

POLICY SAMPLE REVIEWED

A representative sample of the policies issued by the Mercury Insurance Companies was reviewed to determine if the companies were properly and consistently applying their adopted rules, rates, and rating plans. The policies were selected at random. Details concerning the policy file review findings are discussed later in the report under each line of business heading.

In general, policies containing errors that had produced premium overcharges were corrected by endorsement, and the overcharges were refunded to the insureds. Policies that were cited for undercharges or errors that had no premium impact were marked for corrective action at renewal.

Policy errors are categorized in this report as either rating or non-rating errors. Non-rating errors include documentation omissions, forms mismanagement, and other errors that do not directly impact the premium, as well as errors that have resulted in premium differences of less than \$5.00 or 1% of the policy premium, whichever is greater. All other errors that impact the premium are categorized as rating errors.

The Exam Results Summary Table at the top of the next page provides a breakdown, by program, of the number of policies that were reviewed, the number of policies that were found to contain rating and/or non-rating errors, and the resulting error ratios. Additional information concerning the errors presented in this table is provided under the individual line of business headings of the report.

EXAM RESULTS SUMMARY TABLE

<u>Programs</u>	<u>No. of Policies Reviewed</u>	<u>No. with Rating Errors</u>	<u>Error Ratio (%)</u>	<u>No. with Non-Rating Errors</u>	<u>Error Ratio (%)</u>
Homeowners Multi Peril	49	1	2.0%	0	0.0%
Private Passenger Auto					
Voluntary	97	5	5.2	2	2.1
Assigned Risk	25	1	4.0	2	8.0
Commercial Auto	49	8	16.3	14	28.6
Commercial Multi Peril	<u>46</u>	<u>5</u>	<u>10.9</u>	<u>23</u>	<u>50.0</u>
Totals	<u>266</u>	<u>20</u>	<u>7.5%</u>	<u>41</u>	<u>15.4%</u>

HIGH ERROR RATIO

Errors ratios that exceed 5% for personal lines and 10% for commercial lines are considered to be high. High rating error ratios were noted during a review of policies written in the following programs:

Commercial Automobile
Commercial Multiple Peril

Because the 5.2% voluntary personal automobile policy file error ratio is not substantially excessive, it has not been identified as a high error ratio.

High non-rating error ratios were identified in policies written in the following programs:

Assigned Risk Private Passenger Automobile
Commercial Automobile
Commercial Multiple Peril

High error ratios are deemed to be evidence of unfairly discriminatory practices that are in violation of CIC Section 1861.05(a).

To reduce the high error ratios, Mercury will take the following steps:

Personal Lines

CAIC will amend the questionnaire and upgrade the audit system that it uses for underwriting and rating assigned risk private passenger automobile policy files.

Commercial Lines

MCC will revise its commercial automobile rate filing to eliminate schedule rating deficiencies and will automate its Commercial Multiple Peril Department within the next eighteen months. Additionally, MCC will impose tighter controls over the application of filed deductibles and rates.

COMMISSION LEVEL STUDY

A study was made of the average, standard, and filed commission levels maintained by the Mercury Insurance Companies in 1997 for each of the programs described in this report for the purpose of ascertaining whether the commissions paid by the companies for these programs were consistent with the commission percentages recorded in the companies' rate filings. The study revealed that there were no significant variances between the average commissions that the companies paid the producers, the standard commission levels that the companies established for the programs, and the commission percentages that the companies filed with the CDI.

HOMEOWNERS MULTIPLE PERIL

ADOPTED RULES, RATES, AND FORMS

Homeowners Coverage (HO3)

Rate filing date: January 5, 1993

Rate pages edition date: January 1, 1993

Tenants Coverage (HO4)

Rate filing date: January 5, 1993

Rate pages edition date: January 1, 1993

Condominium and Townhouse Unit Owner Coverage (HO6)

Rate filing date: January 5, 1993

Rate pages edition date: January 1, 1993

MCC offers three homeowners multiple peril insurance products: the HO3 homeowners coverage, the HO4 tenants coverage, and the HO6 condominium and townhouse unit owner coverage. The company writes the HO3, HO4, and HO6 homeowners insurance coverages on a monoline policy basis or as a component of the personal package policy. The personal package policy, known as the Personal Protection Package, is comprised of homeowners multiple peril and personal automobile insurance, and may include umbrella coverage, also.

MCC uses a modified Insurance Services Office (ISO) coverage form and independently-developed endorsements. The rates were developed by the company.

The company adopted a list of restricted zip codes in July 1996 for its HO3 product. When asked about the list, management stated that MCC had discontinued writing HO3 policies for dwellings located in the restricted zip codes because its earthquake insurance writings had

met or exceeded its capacity for these areas. The company discontinued using the list on April 1, 1998, when it began writing earthquake insurance under the California Earthquake Authority rating plan.

The examination disclosed that several aspects of MCC's homeowners multiple peril program are inconsistent with California insurance statutes. Management has agreed to resolve all findings except item numbers 2, 6(A), 6(B), 7(A), and 8(B), and will implement the needed corrections within 60 days of the examination report filing date. The unresolved findings will be referred to the CDI Legal Division for review.

A description of the examination findings is presented below along with a summary of management's written reply.

1. MCC informed the producers of two homeowners policies that the deductibles had to be increased due to the insureds' past losses and that the policies would be non-renewed if the deductibles were not increased. In both cases, MCC raised the deductibles mid-term once the producers had reported to the company that the insureds had been advised of, or assented to, the mandatory deductible increases. The deductible increases were implemented 265 and 128 days into the policy periods, respectively.

By processing the deductibles during the policy term rather than at renewal, MCC unilaterally reformed the policy contracts. These reformations violated CIC Sections 678 and 1861.05(a).

In response to this finding, management stated the following:

"It has long been Mercury's policy that any changes in deductibles at our request will only be made effective as part of the next renewal offer. This has been reiterated to all personnel in that (homeowners insurance) department."

2. In a November 6, 1997 letter to the CDI, company management agreed to "revise our homeowners underwriting guidelines (so that) two unrelated individuals residing together will no longer be unacceptable." This agreement was prompted by a finding that MCC had declined to write a homeowners policy for two unrelated men who were co-owners of a dwelling. As stated in the CDI's June 23, 1997 letter to management, MCC's refusal of the men's application violated CCR Section 2560.3, which prohibits insurers from "Denying, cancelling or refusing to renew coverage, or providing coverage on different terms, because the insured or prospective insured is residing with another person or persons not related to him or her by blood or marriage."

The examination disclosed that MCC has not yet fully implemented the terms of the November 6, 1997 agreement. The company has not amended its underwriting guideline, which still states: "The named insured must be an individual or an individual and resident spouse to be eligible." Nor has the company issued a written statement to its producers concerning the agreement. Also, the company is known to have violated the agreement in May 1998 when it non-renewed a policy in violation of CCR Section 2560.3.

In response to this finding, management stated the following:

"A bulletin will be issued that two unrelated individuals residing together will be acceptable as agreed. This has been our policy since November 6, 1997. The file mentioned, HO 12019156, was effective 6/24/97, and set to non-renew 9/17/97 -- prior to our agreement 11/6/97."

The bulletin proposed by management is not an adequate substitute for the revised guideline that management promised in its November 6, 1997 letter to the CDI. This finding is therefore unresolved and will be referred to the CDI Legal Division for review.

3. MCC's underwriting guidelines contain one other ineligibility rule that discriminates against individuals based on their marital status: that is, "Single renters residing in a single family dwelling are not eligible" to purchase renters policies. Given that there is no comparable restriction applied to married individuals, the rule violates CCR Section 2560.3.

Management will delete this ineligibility rule from the manual.

4. MCC's underwriting guideline states: "If the Gated Community credit is allowed, no further credits, including the Newer Home credit..., will be allowed." In practice, however, the company has been awarding both the Gated Community credit and the Newer Home credit to deserving insureds.

In response to this finding, management stated the following:

"This is a misstatement in the underwriting manual and will be corrected. The filed rate plan is consistent with our current practice."

5. MCC's "Basic Policy Information Processing" computer screen includes a space for recording the insured's national origin. The inclusion of the national origin information on an underwriting screen is a violation of CIC Section 679.72.

For correction, management will block the national origin data field from the computer screen.

6. MCC "c-codes" the monoline homeowners and personal package policies of insureds when it determines that they have become ineligible for coverage. Once an insured's policy has been c-coded, MCC will not make any changes to the policy that would increase its exposure. In other words, an insured whose policy has been c-coded can not purchase increased limits or additional coverages for his policy.

The following observations were made concerning MCC's c-coding practice:

A. MCC does not non-renew or cancel every monoline homeowners and personal package policy that has been c-coded. This being the case, it is possible that an insured may regain his eligibility after his policy has been c-coded. However, MCC does not have a procedure in place for identifying each such insured and removing the c-code. Consequently, a c-coded insured who has regained his eligibility may still be refused additional coverage by his producer or MCC. Such inequitable treatment violates CIC Section 1861.05(a) and is censurable under CIC Section 790.06.

In response to this finding, management stated the following:

"For non-good driver risks who are canceled or non-renewed, we propose to inform our agents as to the expiration of the c-coding by simply stating: 'Do not submit until risk qualifies.'"

Management's proposal does not address homeowners insurance, nor does it benefit non-good drivers who regain their eligibility during the policy period. The finding is therefore unresolved and has been referred to the CDI Legal Division for review.

B. MCC has not adopted a written guideline for regulating the c-coding of monoline homeowners and personal package policies. In the absence of such a guideline, MCC can not ensure that the c-codes are applied consistently and equitably among similar insureds. The inconsistent application of the c-code among similarly-situated risks would violate CIC Section 1861.05(a) and would be censurable under CIC Section 790.06.

In response to the foregoing, management stated the following:

"The underwriters will be given written instructions that all policies will be c-coded when set to non-renew."

Management's proposed instruction is open-ended insofar as it is silent as respects other situations for which the c-code is currently being applied; i.e., cancellation decisions, underwriting judgement, et cetera. The proposal is therefore insufficient to cure the code violations.

This finding is unresolved and will be referred to the CDI Legal Division for review.

7. After it has received an insured's homeowners or personal package insurance application, MCC attempts to contact the insured for the purpose of conducting a telephone survey.

The following observations were made concerning the survey:

A. MCC will cancel a monoline homeowners or personal package policy if the insured does not provide answers to questions on the telephone survey that MCC considers to be necessary for accurate underwriting. However, a review of the telephone survey form showed that it does not provide MCC with material underwriting information beyond what is already requested on the application. Assuming that the insured's application has been completed in its entirety, MCC can not reasonably cite a lack of material underwriting information as its reason for canceling a policy when it is unable to conduct a standard telephone survey.

Currently, MCC has no written guidelines by which to ensure that the telephone survey will be waived when the insured's application has been completed in its entirety and MCC has been unable to conduct the telephone survey. The cancellation of a policy by reason of the insured's nonparticipation in the telephone survey would, under such conditions, violate CIC Section 1861.05(a).

In response to this finding, management stated the following:

"The telephone survey is used not only to verify information on the application

(helps to minimize uprates and downrates) but also to get information that has been omitted. The question of whether the telephone survey provides material information is one to be determined by an underwriter. Obviously, if we believed that the significant expense and time involved in telephone surveys simply resulted in information that was immaterial or irrelevant, we would discontinue this 20 year old practice...we do not always get accurate and/or necessary information to accurately rate, qualify, or verify the risk...It is our position that CIC Section 1861.05(a) applies only to rates."

This finding is unresolved and will be referred to the CDI Legal Division for review.

B. MCC has been requesting that insureds call its telephone survey center when it has been unsuccessful in reaching them for the telephone survey. To make this process more convenient and less costly to insureds, MCC will provide them with its toll-free telephone number and offer them the same extended hours that it offers to the assigned risk automobile insureds.

8. The following observations were made concerning MCC's application of the California Earthquake Authority plan and related insurance statutes:

A. The policy file review included an audit of eight monoline/package policies that had been issued for annual coverage terms on or after April 1, 1998, when MCC first began writing earthquake insurance coverage under the California Earthquake Authority rating plan. A study of the Earthquake Acceptance/Rejection Offers that the producers had presented to the eight policyholders showed that an incorrect earthquake insurance premium had been recorded on five (63%) of the eight forms. A sixth Earthquake Acceptance/Rejection Offer did not include a stated premium. In other words, correct earthquake insurance premiums were recorded on two (25%) of the eight Earthquake Acceptance/Rejection Offers that were reviewed. The high error ratio (75%) violates the disclosure requirements of CIC Sections 10081 and 10082.

In response to this finding, management stated the following:

"The initial earthquake premium is quoted by the agent. The files audited were among the first submitted with Mercury as a CEA servicing carrier. The agents are now more familiar with the system, plus marketing and underwriting have been active in agency CEA training. This should resolve the problem on future policies."

B. MCC does not begin issuing the Notice of Non-Coverage for Earthquake until the second policy renewal. In other words, MCC waits until the insured has rejected the first and second earthquake insurance offers before it issues the first Notice of Non-Coverage for Earthquake. The company's practice of waiting until the second policy renewal to issue the Notice of Non-Coverage for Earthquake is inconsistent with CIC Section 10086.1, which requires that the company issue the notice the year following the insured's rejection of the earthquake offer.

In response to this finding, management stated the following:

"Our interpretation of CIC Section 10086.1 is that the notice of non-coverage need be filed only every other year. Thus the notice is required only on new business, and the second, fourth, etc. renewal."

In evaluating management's reply, it is important to note that MCC does not issue the Notice of Non-Coverage for Earthquake to new policyholders. Consequently, the company does not begin sending the notice to insureds until the second policy renewal. This fact was confirmed by management during the policy file review.

This finding is unresolved and will be referred to the CDI Legal Division for review.

C. Contrary to CIC Section 10089.2, MCC has not been providing insureds with a free-standing notice that discloses the earthquake premium discounts that they have not already received.

Management will develop a free-standing notice of the earthquake discounts that are

available to insureds.

Personal Umbrella Program

The examination of MCC's homeowners multiple peril insurance program included a review of the company's personal umbrella underwriting and rating rules. The findings listed below were developed during the course of the review. The findings have not been resolved, and therefore will be referred to the CDI Legal Division for review.

1. MCC's umbrella occupational eligibility rule includes a list of 26 occupations that are labeled "U" for unacceptable. A partial list of the unacceptable occupations is provided below:

Artisans	Junk dealers	Bartenders
Longshoremen	Domestics	Garbage collectors
Military	Iron workers	Door-to-door salesmen

The "U" designations are discriminatory; accordingly, MCC was requested to provide actuarial justification for each "U"-labeled occupation.

In response, management stated the following:

"It is our position that CIC Section 1861.05(a) applies to rates only, not acceptability. We use underwriting judgment to determine acceptability as long as we do not violate any statute or regulation."

This finding is unresolved and will be referred to the CDI Legal Division for review.

2. MCC's umbrella occupational eligibility rule also includes a list of 6 occupations that are labeled "S" for "submit non-bound." These occupations are as follows:

- Artists
- Emergency vehicle drivers
- Automobile claims adjusters employed by other insurers
- People who are self-employed and working out of their homes
- People who are unemployed
- People who work out of their homes and have one source of income

Personal umbrella applications that are submitted for individuals who are employed in occupations that are not labeled "S" are bound by the producers provided the applicants qualify for coverage under the company's other umbrella program guidelines. The company requires that the applications of individuals employed in "S"-labeled occupations be submitted non-bound so that the company can decline the applications if it determines that the applicants are unacceptable. Some of the criteria that the company uses to evaluate these applications are unwritten, a violation of CCR Section 2360.2.

The exposures of the "S"-labeled occupations are not unique to these occupations. By targeting these occupations for special review, the company is failing to apply its underwriting criteria uniformly across all occupations. This being the case, the company is discriminating unfairly against "S"-labeled occupations, and is thereby violating CCR Section 2360.2 and CIC Sections 790.06 and 1861.05(a).

In response to this finding, management stated the following:

"It is our position that CIC Section 1861.05(a) applies to rates only, not acceptability. We use underwriting judgment to determine acceptability as long as we do not violate any statute or regulation."

This finding is unresolved and will be referred to the CDI Legal Division for review.

3. The umbrella underwriting guideline instructs the producer to submit the application of a physically-impaired individual -- that is, an applicant who is diabetic, a cardiovascular patient, or who suffers from some other medical condition -- to MCC as non-bound. The guideline further states that MCC may require that the physically-impaired applicant provide MCC with a medical examination report before the company will issue him an umbrella policy. However, the company has not adopted a written rule by which the underwriters can determine

when they are to request a medical report. Without this rule, there is no assurance that the underwriters will require a medical report from every individual who has a medical condition comparable in type or degree to that of other individuals from whom reports have been requested, which in turn creates the possibility that the underwriters might decline to write umbrella coverage on the basis of an individual's medical condition without first attempting to obtain his medical examination report. In fact, the company recently rejected an umbrella insurance application for a man and his family without first requesting such a report. A note in the company's file states: "Heart condition. Doesn't qualify." There was no information in the file that conclusively showed that the man was ineligible for coverage under the company's written guidelines. The declination therefore violated CIC Sections 790.06 and 1861.05(a). (For purposes of confidentiality, the identity of the company file is not stated in this examination report. The file was identified under item 21 on page 8 of the CDI's July 2, 1998 letter to company management.)

Pursuant to CCR Section 2360.2, management needs to revise the company's underwriting guidelines to be more definitive. Specifically, the underwriting guidelines should require that umbrella coverage be written for any applicant who is a diabetic, a cardiovascular patient, or who suffers from some other medical condition if he qualifies for the coverage and his medical report shows that, in his doctor's opinion, his condition does not prevent him from safely operating a motor vehicle. And, for those medical conditions for which the company does not require a medical report, that coverage be written for the applicant if he qualifies for coverage.

In response to this finding, management stated: "A written guideline will be adopted requiring that all medically impaired risks provide a medical report. Risks receiving a

satisfactory report will be accepted.”

The term “satisfactory” has not been defined by management. Accordingly, this finding will be referred to the CDI Legal Division for review.

APPLICATION OF RULES, RATES, AND FORMS

The examination included a review of 49 in-force homeowners monoline policy files and homeowners package policy sections. One homeowners monoline policy file (number HO12012004), with a premium of \$2,399, was cited for a \$1,430 undercharge that occurred when the homeowners and earthquake premium calculations were based on an incorrect building age. No other policy files were cited for rating or non-rating errors.

Declined, Canceled, or Non-Renewed Policies

The examination also included a review of 34 declined property applications and 41 canceled and non-renewed homeowners monoline policies and personal package policies. The review produced the three findings listed below.

Management has agreed to resolve finding numbers 2 and 3 and will implement the needed corrections within 60 days of the examination report filing date. The remaining finding will be referred to the CDI Legal Division for review.

1. The homeowners and personal umbrella eligibility guidelines include rules for submitting applications as non-bound if the applicants satisfy certain criteria. The criteria are ambiguous and are therefore open to interpretation. In other words, MCC is requiring the underwriters to exercise independent judgement when determining the acceptability of insurance applicants who are subject to the submission criteria. The lack of definitive submission criteria

directly violates CCR Section 2360.2. Moreover, MCC's reliance on the underwriters to independently determine the acceptability of technically eligible risks promotes unfair discrimination, and therefore violates CIC Sections 790.06 and 1861.05(a).

The examination included a review of 34 property applications that had been declined by the company. The review showed that six (18%) of the 34 declinations had been rendered to applicants (18%) who were technically eligible for coverage.

In response to this finding, management stated the following:

"The sections cited do not prohibit the use of underwriting judgment in determining acceptability of risks who are not specifically protected. We interpret both CCR Section 2360.2 and CIC Section 1861.05(a) as guidelines for rates, and do not mean that the insurer needs to accept the applicant. This is provided we do not violate CIC Section 11628(a), which we do not."

This finding is unresolved and will be referred to the CDI Legal Division for review.

2. Of the 34 canceled policies that were reviewed, ten were canceled at the request of the insureds. The premiums that were refunded on two (20%) of these ten policies were found to have been calculated on a pro-rata basis, instead of the short-rate basis required by the company's manual cancellation rule. These deviations from the manual rule violated CIC Section 1861.05(a).

In response to this finding, managements stated: "These policies were canceled pro-rate in error. This was a training issue involving houses that had been sold and has been corrected."

3. MCC cancels a new homeowners monoline or personal package policy when it does not receive a signed Earthquake Acceptance/Rejection Offer from the insured. Policy cancellation is unnecessary insofar as CIC Section 10085 establishes a conclusive presumption of earthquake coverage rejection when the named insured does not accept the earthquake coverage

offer within 30 days from the proven date of its delivery.

In response to this finding, Management stated the following:

“Following the Northridge earthquake, with the multitude of coverage questions, allegations of misconduct, and litigation, we felt it critical to obtain concrete acknowledgment from the insured of the coverages desired.

Now, as part of the CEA, we can agree to your request and will accept failure to return the Earthquake Acceptance/Rejection offer as coverage rejection. The policy will be continued without earthquake coverage in these situations.”

PRIVATE PASSENGER AUTOMOBILE

The Mercury Insurance Companies' private passenger automobile insurance premiums and losses are generated from its voluntary personal automobile insurance program and assignments that it receives from the California Automobile Assigned Risk Plan (CAARP).

The examination included a review of Mercury's private passenger automobile insurance rating and underwriting practices. The results of this review are described on the following pages of this report.

Underwriting Results

The following table shows the private passenger automobile insurance premiums earned and losses incurred by Mercury during the 1995, 1996, and 1997 calendar years, combined.

<u>Program</u>	<u>Earned Premium</u>	<u>Incurred Losses</u>	<u>Loss Ratio (%)</u>
Voluntary Personal Automobile	\$2,106,582,916	\$1,124,399,713	53.4%
Assigned Risk Automobile	<u>42,087,086</u>	<u>16,973,483</u>	<u>40.3</u>
Totals	<u>\$2,148,670,002</u>	<u>\$1,141,373,196</u>	<u>53.1%</u>

VOLUNTARY PERSONAL AUTOMOBILE PROGRAM

ADOPTED RULES, RATES, AND FORMS

Rate filing date: July 8, 1997

Rate pages edition date: October 1, 1997

Voluntary personal automobile insurance is written by MIC and MCC. Both companies offer the same class plan and independently-developed coverage form. Both companies share the same underwriters and are operated by the same management. And, both companies insure good and non-good drivers.

Policy rating is automated, and premiums are based on rating factors promulgated by CCR Section 2632.5. Various premium credits, including the good driver discount, are contained in the rating plan.

From an operational standpoint, the companies differ primarily in their application submission requirements. Producers are required to submit insurance applications for good drivers to MIC and to send applications for non-good drivers to MCC. The companies maintain these submission requirements for rate-making purposes; but, the companies do not reject applications that are misdirected by the producers.

Several aspects of MIC's and MCC's personal automobile program are inconsistent with California insurance statutes and regulations. The companies' method of establishing the insured's physical damage limit of liability is one such example. The insurance application used by the companies requires that the insured state his vehicle's cost or value. The amount reported by the insured on the application is recorded on his personal automobile policy declaration page. The declaration page contains a clause that states: "...the limit of liability for comprehensive and

collision coverage shall not exceed the (stated vehicle) 'cost'...." In other words, the vehicle value recorded on the application is the maximum amount of indemnification that the insured can receive under the physical damage section of the policy if he incurs a total loss to the vehicle.

This method of establishing a maximum physical damage limit of liability violates at least two insurance statutes. First, the companies are violating the CIC Section 332 disclosure requirement by not notifying the insured when he is completing the application that the vehicle value that he reports on the application will become the physical damage limit of liability on his policy. And second, the companies are violating the CIC Section 1861.05(a) excessive and unfair rate prohibitions by failing to ensure that the amount of premium being charged is appropriate for the physical damage limit of liability recorded on the policy declaration page.

The CDI's Market Conduct Bureau is currently investigating the companies' physical damage claims payment procedures. Further action on the CIC Section 332 and 1861.05(a) violations will be based on the results of that investigation.

The remaining personal automobile examination findings are described below along with a summary of management's written reply. Management has agreed to resolve finding numbers 1(I), 1(J), 1(K), 1(M), 1(N), 1(O), 1(P), 2(D), 3(A), 5(B), 6(A), and 6(B), and will implement the corrections within 60 days of the examination report filing date. The unresolved findings will be referred to the CDI Legal Division for review.

For purposes of simplicity, MIC and MCC will be referred to collectively as "Mercury's" in the remaining portion of the Voluntary Personal Automobile Program section of the examination report.

1. The following was observed concerning Mercury's personal automobile underwriting and rating guidelines.

A. The "Occupations" ineligibility guideline states that applications are to be submitted non-bound for non-good drivers employed in the following occupations:

- * Artists
- * Emergency vehicle drivers
- * Insurance -- automobile and personal injury liability claims adjusters
- * Military
- * Applicants employed in the entertainment industry as actors, dancers, et cetera

Applications that are submitted for individuals who are employed in occupations other than those listed above are submitted as bound by the producers provided the applicants qualify for coverage under Mercury's other guidelines. Mercury requires that the applications of artists, emergency vehicle drivers, et cetera be submitted non-bound so that it can decline the applications if it determines that the applicants are unacceptable. Some of the criteria that Mercury uses to evaluate these applications are unwritten, a violation of CCR Section 2360.2.

The exposures of the above-listed occupations that Mercury wants to underwrite are not unique to these occupations. By targeting artists, emergency vehicle drivers, et cetera for special review, Mercury is failing to apply its underwriting criteria uniformly across all occupations. This being the case, Mercury is discriminating unfairly against artists, emergency vehicle workers, et cetera on the basis of their occupations when it declines their applications, and is thereby violating CCR Section 2360.2 and CIC Sections 1861.05(a) and 11628(c).

In response to this finding, management stated the following:

"We read CCR Section 2360.2 as applicable to the proper rating of risks and not applicable to acceptability. We read CIC Section 1861.05(a) as only applicable to rates. As respects CIC Section 11628(c), please see CIC Section 11628(c)(2) and (d). We do not believe the CIC or the CCRs require us to accept risks that fall into the exceptions to the definition of occupation (CIC

Section 11628(c)(2) last paragraph) and do not qualify as good drivers....”

As shown on page 62 of this examination report, Mercury’s reliance upon its underwriters to independently determine the acceptability of technically eligible risks has resulted in some risks being written while similarly-situated risks are not. There were 51 declination files reviewed during the examination. The declinations were issued for various reasons, including the applicant’s medical condition, age, occupation, et cetera. Eleven of the declinations (21.6%) were issued to applicants who were technically eligible to purchase personal automobile insurance under Mercury’s eligibility guidelines. These acts of unfair discrimination violated CIC Section 1861.05(a) and were censurable under CIC Section 790.06.

This finding is unresolved, and will therefore be referred to the CDI Legal Division for review.

B. The “Occupations” ineligibility guideline also states that the applications of non-good drivers employed in the military are to be submitted non-bound, also. No exemption is included in the guideline for military personnel who are on active duty service in the United States Armed Forces (i.e., on-call at the United States military 24 hours a day). The absence of such an exemption from the ineligibility guideline is inconsistent with CIC Section 11628(c), which states: “No admitted insurer, licensed to issue and issuing motor vehicle liability insurance policies...shall fail or refuse to accept an application, refuse to issue that insurance to an applicant therefor, or cancel that insurance solely for the reason that the applicant for that insurance or any insured is...on active duty service in the United States Armed Forces.”

This problem was cited on page 23 of the 1994 California Rating and Underwriting Examination Report and was to have been corrected by Mercury.

In response to this finding, management stated the following:

“...As respects CIC Section 11628(c), please see CIC Section 11628(c)(2) and (d). We do not believe the CIC or the CCRs require us to accept risks that fall into the exceptions to the definition of occupation (CIC Section 11628(c)(2) last paragraph) and do not qualify as good drivers....”

As shown on page 60 of this examination report, Mercury’s reliance upon its underwriters to independently determine the acceptability of technically eligible risks has resulted in Mercury’s declination of applicants who were technically eligible to purchase personal automobile insurance under Mercury’s eligibility guidelines. These unlawful declinations were issued for various reasons, including the applicant’s medical condition, age, and occupation.

This finding is unresolved, and will therefore be referred to the CDI Legal Division for review.

C. The “Occupations” ineligibility guideline states that Mercury will write personal automobile policies for individuals employed in the following occupations only if they are good drivers, with the proviso that Mercury may limit their coverage to listed vehicles, only:

- * Auto salespersons, sales managers, new/used car dealers and their employees
- * Auto rebuilders, salvage dealers, wreckers and their employees
- * Auto rental and leasing personnel unless employed by national firms such as Avis, Hertz, et cetera
- * Auto repossessioners and their employees
- * Messengers -- using the insured vehicle in their occupation
- * Motor vehicle salespersons and sales managers

Mercury uses “stripper” endorsement form U-178 (7/96) to delete the non-owned automobile liability coverage.

By limiting the good driver’s coverage to the vehicles listed on his policy, Mercury is denying him the full use of the non-owned, personal use automobile coverage that is provided in the standard coverage form. In so doing, Mercury is failing to comply with CCR Section

2632.14, which states that the insurer is to offer the good driver a policy that contains any of the types of coverage that the insurer offers to sell to the public.

In response to this finding, management stated the following:

“As respects the use of ‘stripper’ endorsement U-178 (7/96), our policy, and I believe policies in general, exclude or restrict coverage for non-owned automobiles used in the automobile business. Automobile business means the business or occupation of selling, repairing, servicing, storing, parking, delivering, testing or road testing motor vehicles.

We feel it is prudent to clearly exclude coverage for non-owned autos and for those occupations that are very likely to use non-owned autos under conditions for which the policy does not provide coverage. As we read CCR Section 2632.14, the intent is to require that good drivers do not receive less coverage than non-good drivers. We use the ‘stripper’ endorsement on all drivers in these occupations, good drivers or non-good drivers.”

From the point of view of the analysts, three key facts should be taken into consideration when examining the foregoing statement from management. First, the protections extended by CCR Section 2632.14 to good drivers are not divisible on the basis of occupation because the protections are afforded to the “public” in general. Second, the “stripper” endorsement removes all coverage afforded under the policy for non-owned automobiles -- including coverage for those non-owned automobiles that the insured drives for his personal use -- and to that extent is more restrictive than Mercury’s personal automobile policy jacket, which only excludes coverage for losses arising from the insured’s use of non-owned automobiles in his or his employer’s automobile business. And third, Mercury does not ordinarily have cause to add the “stripper” endorsement to the policies of non-good drivers employed in the above-listed occupations because Mercury’s “Occupations” ineligibility guideline states that Mercury will not write coverage for these individuals.

This finding is unresolved and will be referred to the CDI Legal Division for review.

D. The "Occupations" ineligibility guideline prohibits producers from binding coverage for non-good drivers who are self-employed in businesses operated out of their places of residence. However, the guideline does not include criteria for underwriting the non-bound applications that the producers submit for these non-good drivers. Without such criteria, each underwriter must apply his own personal judgement when deciding which risks to write, which in turn means that Mercury will end up writing policies for some self-employed people while rejecting the applications of others who have similar exposures. The lack of definitive underwriting criteria violates CCR Section 2360.2. The acts of unfair discrimination violate CIC Section 1861.05(a) and are censurable under CIC Section 790.06.

In response to this finding, management stated the following:

"Our underwriters use their judgement in accepting risks unless the rejection would violate some statute or regulation. We believe it is lawful to accept some self employed and decline others so long as the applicant is not a good driver and we do not violate CIC Section 11628(a)."

As shown on page 60 of this examination report, Mercury's reliance upon its underwriters to independently determine the acceptability of technically eligible risks has resulted in Mercury's declination of applicants who were technically eligible to purchase personal automobile insurance under Mercury's eligibility guidelines. These unlawful declinations were issued for various reasons, including the applicant's medical condition, age, and occupation.

This finding is unresolved and will be referred to the CDI Legal Division for review.

E. The "Unacceptable Drivers" ineligibility guideline states that "students with less than 10 years" residency in the United States are unacceptable for coverage if they are non-good drivers. This "Students" rule is virtually identical to its 1994 forebear, which was cited on page 21 of the 1994 California Rating and Underwriting Examination Report as being incompatible

with CIC Section 11628(a) because it discriminates against students who originate from countries outside of the United States.

Mercury had agreed to discontinue the 10-year residency requirement in 1995, but has not done so.

In response to the current finding, management stated the following:

“Please note that the manual rule used at that time (referring to the 1994 California Rating and Underwriting Examination) did not refer to students at all. It simply referred to non-good driver citizens of countries other than the U.S. or Canada who have not resided in California and held a California drivers license for five years. We agreed to delete this rule and we did. We have no problem with insuring students whose countries of origin are other than the U.S. or Canada provided they continue to reside in the U.S....”

The foregoing statement does not acknowledge that there was a separate “Students” rule in the May 1994 edition of Mercury’s “Unacceptable Drivers” manual guideline.

Management’s assurance that Mercury will insure “students whose countries of origin are other than the U.S. or Canada provided they continue to reside in the U.S.” does not satisfactorily resolve its original agreement to “discontinue the 10-year residency requirement” because the 1997 edition of the “Students” rule still states: “Students with less than 10 years residency in the United States” are unacceptable for coverage if they are non-good drivers.

This finding is unresolved and will be referred to the CDI Legal Division for review.

F. The “Physically Impaired” ineligibility guideline states that Mercury may require that the physically-impaired applicant -- that is, the applicant who is a diabetic, a cardiovascular patient, or who suffers from some other medical condition -- provide Mercury with a medical examination report that attests to his ability to safely drive a motor vehicle. However, Mercury has not adopted a written rule by which the underwriters can determine when they are to request

medical reports. Without this rule, there is no assurance that the underwriters will require a medical report from every individual who has a medical condition comparable in type or degree to that of other individuals from whom reports have been requested, which in turn creates the possibility that the underwriters might decline to write coverage on the basis of an individual's medical condition without first attempting to obtain his medical examination report. Such an unfairly discriminatory decision would violate CIC Section 1861.05(a) and would be censurable under CIC Section 790.06.

Mercury's need to adopt a rule for ordering medical examination reports goes hand in hand with its need to amend its underwriting guidelines to require that personal automobile coverage be written for any applicant who is a diabetic, a cardiovascular patient, or who suffers from some other medical condition if he qualifies for the coverage, is licensed to drive, and has a satisfactory medical report. And, for those medical conditions for which Mercury does not require a medical report, that coverage be written for the applicant if he qualifies for coverage and is licensed to drive. Mercury's present lack of such definitive underwriting criteria violates CCR Section 2360.2.

In response to the foregoing, management stated the following:

"...We believe it is lawful to accept some non good driver diabetics and reject others as long as we do not violate CIC Section 11628(a).... We believe it is lawful to use underwriting judgement in accepting or rejecting non-good driver diabetics or other non good driver medically (as opposed to physically) impaired risks."

In other words, Mercury is asserting that it does not need to amend its guidelines because it has interpreted the law as allowing it to decline the application of any non-good driver who is a diabetic, a cardiovascular patient, or who suffers from some other medical condition even if he

qualifies for coverage, is licenced to drive, and has a satisfactory medical report. In fact, Mercury recently declined to write a policy for an individual who had submitted a favorable medical report and who qualified for coverage under Mercury's guidelines. That declination violated CIC Section 1861.05(a) and was censurable under CIC Section 790.06. (For purposes of confidentiality, the identity of the company's declination file is not stated in this examination report. The file was identified under item 1(E) on page 2 of the CDI's May 5, 1998 letter to company management.)

This finding is unresolved and will be referred to the CDI Legal Division for review.

G. The underwriting manual states that Mercury "may decline" to write liability limits greater than \$15,000/\$30,000/\$10,000 for "some" non-good driver risks that satisfy two or more of the rule's criteria. The rule's language is ambiguous, which creates the potential for different interpretations and, inevitably, violations of the CIC Section 1861.05(a) unfair discrimination prohibition. For example, the words "may decline" and "some risks" suggest that Mercury does not always enforce the coverage limit restriction. Also, the rule does not state whether the limit restriction applies to new and existing insureds, or just new insureds. If Mercury intends to apply the rule to existing insureds, it needs to clarify the rule to show whether its application is to be limited to insureds who only have \$15,000/\$30,000/\$10,000 limits to begin with, or if it is to be used to prevent insureds with higher limits from purchasing more.

In response to this finding, management stated that CIC Section 1861.05(a) "refers only to 'rates,' not acceptability."

This finding is unresolved and will be referred to the CDI Legal Division for review.

H. The underwriting manual states that in order for an insured to qualify as a good driver, he “must have been continuously licensed to drive a motor vehicle for the preceding three years with a valid U.S. or Canadian license for all of the last 18 months.” This good driver eligibility requirement violates the CIC Section 1861.02(b)(1) “all comers” provision because it is more restrictive than CCR Section 2632.13(i) and CIC Section 1861.025(d), which do not prevent insureds from qualifying for the good driver discount if they have held a valid license from a nation other than the United States or Canada during the previous 18 months.

Mercury’s notice of discounts references the underwriting manual’s United States/Canada licensing requirement, and so is in violation of CIC Section 1861.02(b)(1), also.

In response to this finding, management stated: “Please see CIC Section 1861.025(d) for the 18 month requirement.”

This finding is unresolved and will be referred to the CDI Legal Division for review.

I. The manual states that an insured does not qualify for the good driver discount if he has had more than one violation point count. This rule is inconsistent with subparagraphs (a) and (b)(1) of CCR Section 2632.13, which stipulate that an insurer can assign a point for a traffic violation for the purpose of determining good driver discount eligibility only if the insured has been convicted of that traffic violation.

In response to this finding, management stated: “We are willing to amend this rule to read ‘one violation point count conviction.’”

J. In practice, Mercury has expanded the three year timeframe for establishing good driver discount eligibility to seven years for insureds who have been convicted of drunk driving, manslaughter, and other violations referenced by CIC Section 1861.025(c). Pursuant to CIC

Section 1861.05(b), Mercury needs to file an amendment to the manual that shows this change.

Management has agreed to include this change in the filing that it is preparing to send to the CDI.

K. The underwriting manual states in part: "The Company will waive the last 30 days of the experience period for accidents and convictions when establishing eligibility and computing premium." In practice, Mercury is also waiving the last 30 days of the insured's age and years of driving experience for the purpose of establishing eligibility and computing premium.

Pursuant to CIC Section 1861.05(b), management will include the age and years of driving experience changes in the filing that it is preparing to send to the CDI.

L. Mercury's April 10, 1996 "Underwriting Update" bulletin indicates that it automatically charges for any accident recorded on the Comprehensive Loss and Underwriting Exchange (CLUE) report for which a claims reserve has been opened unless the CLUE report shows that the insured is not at fault, or that the reserve has been closed without payment.

Many insurers will open a claims reserve prior to determining whether an insured is at fault for an accident. This being the case, an open reserve can not be cited as proof of chargeability under CCR Section 2632.13(f)(1). The fact that the CLUE report does not state that the accident is not chargeable can not be cited as proof that the insured is at fault for the accident either, because the CLUE report often does not state whether accidents are chargeable. Consequently, Mercury is prohibited by CCR Sections 2632.5(c)(1)(B) and 2632.13(a) from automatically charging for an accident recorded on the CLUE report when its sole basis for doing so is the fact that a claims reserve has been established for the accident and the insured is not reported as being not at-fault.

In response to this finding, management stated the following:

"CCR Section 2632.13(f)(1) provides that if the previous insurer charged the driver with a violation point then it is a chargeable loss."

We don't believe insurers set up BI or PD reserves before investigating the accident. The reserves are generally based on the insured's report of the accident. The automatic rating of renewals based on loss information would and should preclude inaccurate reserves remaining in place very long. To do so would mean many policyholders may lose their good driver discount erroneously. BI, PD reserves sometimes stay up for two or three years before they are paid."

The analysts have verified through the CDI's Market Conduct Bureau that it is a common practice of personal automobile insurers to establish an automobile liability or physical damage claims reserve prior to determining an insured's fault status. Mercury must implement the steps outlined in CCR Section 2632.13(f) in order to ascertain whether an insured was principally at fault for an accident recorded on his CLUE report if his fault status is not shown on the report.

This finding is unresolved and will be referred to the CDI Legal Division for review.

M. Mercury's Summer 1996 "Underwriting Update Newsletter" states in part: "Vehicle Inspection Law Compliance -- Should the producer fail to comply with the vehicle inspection photo or U-79 (automobile inspection form) requirements, we will issue the policy, memo for compliance, and give the producer a 2 week reply date. If the producer does not respond to the request within the u/w (underwriting) time period, send cancellation notice, reason #17 (substantial increase in hazard)." This rule violates the California mandatory vehicle inspection law as codified in CIC Sections 401 and 402, which do not recognize policy cancellation as being an acceptable procedure.

In response to this finding, management stated the following:

"...CIC Sections 401 and 402 and the applicable regulation will sunset 1/1/99. CIC Section 402(d) provides for suspensions of collision and comprehensive

coverage if the inspection is not conducted within 7 days of deferral. We will follow this procedure and notify the insured as required by CIC Section 402(e).”

N. The October 1997 “Mercury Underwriting Update” states in part: “If the insured’s license has been suspended in excess of one year, the Date First Licensed may be adjusted to disallow credit for the suspended years (for the purpose of calculating the driving experience rating factor).” In practice, Mercury is limiting the application of this rule to continuous license suspensions that last more than a year. This being the case, Mercury is reducing the driving experience period for insureds whose licenses have been suspended for more than a year, while allowing full credit for insureds whose licenses have been suspended for lesser periods of time that, when totaled, add up to more than a year. The targeting of long-term, continuous license suspensions promotes unfair rate discrimination, a violation of CIC Section 1861.05(a).

Another unfairly discriminatory aspect of this rule is that it is only applied to new policies.

For correction, management stated that it will “...file the proper amendment applicable to new and renewal policies and aggregate the periods of suspension...”

O. The October 1997 “Mercury Underwriting Update” states in part: “The good driver discount may be deleted on (new business) risks that have allowed their driver’s license to lapse in excess of 6 months” The exclusive application of this rule to new insureds violates the unfair rate discrimination prohibition of CIC Section 1861.05(a).

For correction, management will file an amendment applicable to new and renewal policies.

P. Mercury's "Underwriting Update" newsletters contain rating rules that have not been filed. Some of the rules that should have been filed are described under finding numbers 1(L), 1(N), and 1(O), above.

Pursuant to CIC Section 1861.05(b), management will file the rating rules.

2. The following was observed during the review of Mercury's telephone survey procedures.

A. Currently, Mercury is attempting to conduct a telephone survey of each insured who has been issued a personal automobile insurance policy. Mercury makes three attempts to contact the insured before a) requesting the producer's assistance in scheduling the survey and b) issuing the CCR Section 2632.19(b)(1) information request letter to the insured. Mercury may waive a survey if it does not contact the insured after the first three tries. If Mercury does not waive the survey, it will cancel the insured's policy if the insured does not respond to the producer and the information request letter.

The telephone survey is a standard form developed by Mercury, and it is used by Mercury to verify the information that is recorded on the insured's application. The underwriters have the authority to waive a telephone survey if they determine that the survey would not yield material underwriting information. The waiving of the telephone survey is currently a matter of individual judgment insofar as Mercury has not established a permanent, objective guideline for the underwriters' use in identifying those risks for which the survey is to be waived. The lack of an objective waiver guideline means that the underwriters will not waive the telephone surveys for all similarly-situated insureds, which in turn means that the policies of some of these insureds will be canceled unless the insureds participate in the telephone surveys. This dissimilar

treatment of similar insureds is unfairly discriminatory and violates CIC Section 1861.05(a).

Mercury's lack of an objective waiver guideline also creates the scenario for additional code violations. The telephone survey does not provide Mercury with material underwriting information that is not already recorded on the application form. This being the case, Mercury can not claim that its inability to conduct a survey represents a substantial increase in hazard if the insured's application has been completed in its entirety. But, Mercury has no objective guideline in place with which to ensure that surveys will be waived for those insureds who have submitted a completed application. And if Mercury does not waive surveys for insureds who have submitted a completed application, Mercury will cancel their policies, thereby violating CCR Section 2632.19(b)(1) and CIC Section 1861.03(c)(1).

In response to these criticisms, management stated the following:

"The telephone survey is used not only to verify information on the application (helps to minimize uprates and downrates) but also to get information that has been omitted. The question of whether the telephone survey provides material information is one to be determined by an underwriter. Obviously, if we believed that the significant expense and time involved in telephone surveys simply resulted in information that was immaterial or irrelevant, we would discontinue this 20 year old practice. We believe this practice conforms to CCR Section 2632.19(b)(1)...we do not always get accurate and or necessary information to accurately rate, qualify, or verify the risk."

This finding is unresolved and will be referred to the CDI Legal Division for review.

B. The telephone survey includes the following question:

"How many accidents have you or any driver been involved in during the past 3 years, including accidents that were not your fault? Number _____."

Mercury uses the accident count reported by the insured to calculate the insured's premium. This being the case, Mercury needs to phrase the question to request that the insured identify the non-fault accidents that he has included in the total accident count. Without such

information, Mercury may be charging for non-fault accidents in violation of subpart (c)(1)(B) of CCR Section 2632.5 and subparts (a), (d), (f) and (g) of CCR Section 2632.13.

In response to this finding, management stated: "We believe that we can solve this by a following question that asks, how many of these were partially or totally your fault?"

The resolution proposed by management does not provide sufficient clarification to ensure that Mercury will not charge for non-fault accidents as defined in CCR Section 2632.13(c) and (d).

This finding is unresolved and will be referred to the CDI Legal Division for review.

C. Mercury has been requesting that insureds call its telephone survey center when Mercury has been unsuccessful in reaching the insureds for the telephone survey. To make this process more convenient and less costly to insureds, Mercury will provide them with a toll-free telephone number and offer them the same extended hours that it offers to its assigned risk automobile insureds.

3. The following was observed about Mercury's compliance with the advance notice requirements of CCR Section 2632.19(b)(1).

A. The information request that Mercury includes in its advance notice requirements letter to the insured is usually phrased as follows:

"We recently advised your producer that we needed some additional information and/or documents from you. In order to continue your insurance coverage without interruption, please furnish the requested information and/or documents promptly. If you have already complied with our request, we wish to thank you for your courtesy and quick response."

This wording reveals that Mercury is relying upon the producer to contact the insured to request the "additional information and/or documents" referenced in Mercury's advance notice

requirements letter to the insured. If Mercury does not receive this information on time, it terminates the insured's policy.

Because Mercury's advance notice requirements letter does not identify the information that Mercury wants, the letter itself provides insufficient proof of Mercury's compliance with CCR Section 2632.19(b)(1). The producer's correspondence to the insured must therefore compensate for this omission. In other words, the producer's request for the additional information and/or documents must identify the insuring Mercury company, must be in writing, and must be mailed at least 30 days in advance of the information due date in order for Mercury to fulfill the requirements of CCR Section 2632.19(b)(1).

The examination included an audit of the producer correspondence that was sent to 15 insureds in furtherance of Mercury's advance notice requirements letters. The following table shows whether the producers a) identified the insuring company, b) requested the information in writing, and c) gave the insureds 30 days notice of the information being requested.

Producer Correspondence

<u>Policy Number</u>	<u>Written Notice Sent to Insured?</u>	<u>Thirty Days Notice Given?</u>	<u>Insuring Company Identified?</u>
AP 03169800	Yes	Yes	Yes
	No	No	No
AP 05127920	No	No	No
AP 05113132	Yes	Yes	No
AP 05125814	Yes	Yes	Yes
AP 03159816	Yes	Yes	Yes
AP 05120213	No	No	No
AP 05122400	No	No	No
AP 02058582	Yes	Yes	Yes
	No	No	No
AP 02082101	Yes	No	Yes
AP 03157669	No	No	No
AP 05111812	No	No	No
	No	No	No
AP 03156123	No	No	No
	No	No	No
	No	No	No
AP 08196806	No	No	No
AP 04186803	Yes	No	No
AP 02059416	No	No	No

The table shows that the producers frequently did not give the insureds a written notice of Mercury's additional information and/or document requirements. This being the case, Mercury is not in full compliance with CCR Section 2632.19(b)(1). Moreover, when Mercury terminates a policy because the insured has not responded to a non-conforming advance notice requirements letter, it is violating CIC Section 1861.03(c)(1).

Mercury's failure to comply with the CCR Section 2632.19(b)(1) advance notice requirements law was cited on page 29 of the 1994 California Rating and Underwriting Examination Report.

In response to this finding, management stated: "We will change our procedure so that the letter is mailed by the company direct to the insured identifying the information we need."

B. Mercury was cited on page 28 of the 1994 California Rating and Underwriting Examination Report for violating CIC Section 1861.03(c)(1) by terminating the policies of insureds who would not sign a driver exclusion form to exclude non-licensed individuals from coverage. Mercury agreed in 1995 to discontinue that practice and subsequently adopted the following U-45 driver exclusion forms for the purpose of distinguishing between residents of the insured's household who are licensed to drive and those who are not:

U-45A -- Used to exclude a licensed person who is not already excluded from coverage.

U-45C -- Used to exclude an unlicensed person who is not already excluded from coverage.

If Mercury discovers from its review of a policyholder's CLUE report or telephone survey that there is an individual residing at the policyholder's address who is not listed on the policy as being either a covered or an excluded driver, Mercury will mail either a U-45A or a U-45C form to the policyholder for him to sign. If Mercury sends a U-45A form, it will also send the advance notice requirements letter so that it can cancel the policy if the policyholder does not sign the form. If Mercury sends a U-45C form, however, it will not send the advance notice requirements letter.

In theory, Mercury's U-45A/U-45C procedure appears to ensure its compliance with the 1995 agreement. In practice, however, the procedure has two major flaws. First, the underwriters are listing unlicensed, non-drivers on the U-45A form if at least one other person included on the form is licensed. If the policyholder refuses to sign the U-45A form because he does not want to exclude the unlicensed, non-drivers from coverage, Mercury will cancel his policy as stated in the advance notice requirements letter. For example, the CDI was contacted

by a policyholder who complained that Mercury was requiring her to exclude her three young children from the policy. A review of her policy file showed that the children were listed on a U-45A form along with three other people. The children were all under five years of age.

The policy file review also showed that the underwriters are issuing the U-45C form together with other forms and information requests and that on such occasions it is not unusual for the underwriters to send the advance notice requirement letter to the insureds, too. The issuance of the advance notice requirements letter concurrently with the U-45C form can easily give the policyholder the impression that Mercury will cancel his coverage if he does not sign the U-45C form.

In response to this finding, management stated: "Mercury will use the U-45C only for non drivers and use the U-45A or U-45B for drivers. We will only issue the U-202B letter (the advance notice requirements letter) on the U-45A and specify return of the U-45A."

Management's proposed resolution appears to be no more than a re-statement of Mercury's existing written procedures and, if so, does not resolve the CIC Section 1861.03(c)(1) violations described above. Management's proposal does not guarantee that Mercury will not list unlicensed, non-drivers on the U-45A form, nor does it explain how Mercury will communicate to insureds that the U-45C form is exempt from Mercury's advance notice requirements letter. This finding is therefore unresolved, and will be referred to the CDI Legal Division for review.

4. Mercury "c-codes" the policies of insureds when it determines that they have become ineligible for coverage under its ineligibility criteria. Once a policy has been c-coded, Mercury will not make any changes to the insured's policy that would increase its exposure. In other

words, an insured whose policy has been c-coded can not purchase additional limits or coverages, or add vehicles or drivers to his policy.

The following was observed concerning Mercury's c-coding procedure:

A. Not all policies that have been c-coded are canceled or non-renewed. This being the case, it is possible that an insured may regain his eligibility after his policy has been c-coded. However, Mercury does not have a procedure in place for identifying each such insured and removing the c-code. Consequently, a c-coded insured who has regained his eligibility may still be refused additional coverage by his producer or Mercury. Such inequitable treatment violates CIC Section 1861.05(a) and is censurable under CIC Section 790.06.

In response to this finding, management stated the following:

"For non good driver risks who are canceled or non renewed, we propose to inform our agents as to the expiration of the 'C' by simply stating 'Do not submit until risk qualifies as a good driver.'"

Management does not state whether Mercury will remove c-codes from the in-force policies of non-good drivers who have regained their eligibility to purchase coverage under Mercury's guidelines, but management makes it clear that the stigma of the c-code continues after the policy has been cancelled until the non-good driver becomes a good driver. In either case, management's proposal is inconsistent with CCR Section 2360.2 and CIC Sections 790.06 and 1861.05(a) insofar as it does not ensure that the c-code will be removed from non-good drivers who have regained their eligibility under Mercury's personal automobile guidelines.

This finding is unresolved and will be referred to the CDI Legal Division for review.

B. Mercury has not adopted a written guideline for regulating the c-coding of personal automobile policies. In the absence of such a guideline, Mercury can not ensure that the c-codes

are applied consistently and equitably among similar risks. The inconsistent application of the c-code among similarly-situated insureds violates CIC Section 1861.05(a) and is censurable under CIC Section 790.06.

Management did not provide a response to this finding.

This finding is unresolved and will be referred to the CDI Legal Division for review.

5. The following was observed concerning Mercury's upward premium adjustment procedures:

A. The examination included a review of 50 newly issued personal automobile policies. The review showed that the premiums quoted by the producers to 24 of the policyholders (48%) had been adjusted upward by Mercury. Thirteen uprates were attributed at least in part to Mercury's removal of persistency, good student, and anti-theft discounts when the producers failed to submit the required documentation for these discounts with the insureds' applications. Mercury also uprated three quoted premiums due to the producers' assignment of incorrect symbols. In short, 14 (58%) of the 24 premium uprates were attributed at least in part to causes that were preventable by Mercury and its producers.

As indicated in the foregoing, Mercury's producers sometimes include the persistency, good student, and anti-theft discounts in their premium quotes before they have obtained the documentation needed to support these credits. The producers then submit the applications to Mercury without this documentation. Part of the time, Mercury sends a request for the missing documentation in lieu of implementing an immediate premium uprate. At other times, Mercury uprates the premium immediately upon its receipt of the application. On these latter occasions, Mercury does not attempt to obtain the missing documentation before it bills the insured for the

additional premium. The inconsistency in Mercury's sequencing of its documentation request/premium uprate procedure is unfairly discriminatory towards the insureds whose premiums are immediately uprated, and therefore violates CIC Section 1861.05(a).

Moreover, Mercury is ultimately responsible under CIC Section 1861.05(a) for ensuring that the premium quotation service that it provides to the public is relatively free of error so that the number of upward premium adjustments is minimized. Since Mercury allows producers to submit applications without the documentation needed to substantiate the persistency, good student, and anti-theft discounts that they have included in their premium quotations, Mercury needs to give each insured sufficient time to produce these documents before it adjusts their premiums upward. Also, Mercury needs to ensure that the incidences of incorrect vehicle symbols and other readily preventable errors are minimized.

Premium uprate-related grievances are the most frequent complaints that the CDI receives from Mercury's insureds.

In response to this finding, management stated the following:

"The persistency uprates are due to the insured's inability to furnish the required documents (i.e., evidence of automobile liability insurance for the past one to five years) after the insured has applied. Applicants want to be bound immediately where possible. They rarely have the required documents in hand when they apply for coverage just as they don't have a current motor vehicle record with them. We bind them on the assumption that the information given the agent with respect to persistency and driving safety records is accurate. The agent can not hold coverage bound indefinitely, without submitting an application, while waiting for documents...."

This finding is unresolved and will be referred to the CDI Legal Division for review.

B. Mercury orders a motor vehicle record (MVR) for each driver recorded on the submitted application form. If a MVR discloses an accident that is not reported on a driver's

application, Mercury will automatically uprate the policy premium using the applicable surcharge for an at-fault bodily injury accident. Mercury will also remove the good driver discount, if previously assigned. The premium uprate is then recorded on the policy declaration page along with the accident information.

As stated in finding number 1(N) above, Mercury is prohibited by CCR Sections 2632.5(c)(1)(B) and 2632.13(a) from charging for an accident if it has not first established under CCR Section 2632.13 that the driver was principally at-fault. Mercury's automatic uprating of premiums for accidents disclosed on the MVR violates these code sections.

In response to this finding, management stated: "We will not issue the policy until the fault question has been decided in accordance with CCR Section 2632.13 and particularly CCR Section 2632.13(g)."

In stating that Mercury will adhere to CCR Section 2632.13, management is implying that Mercury will conform its practices to all of CCR Section 2632.13, including subpart (c), which states the following:

"A driver may be considered to be principally at fault in an accident if the driver's actions or omissions were at least 51 percent of the proximate cause of the accident, ... , and, in accidents not resulting in death, if the total loss or damage caused by the accident exceeded \$500.00."

6. The following observations were made concerning Mercury's personal automobile notices, forms, and computer screens.

A. The cancellation clause of the personal automobile coverage form states in part:

"This policy may be canceled by the named insured by mailing a written request for cancellation to the company or its agent. Coverage shall cease and the policy period shall end on the latest date listed below:

(1) 12:01 a.m. of the day specified by the named insured in the request for cancellation.

(2) 12:01 a.m. of the day following the postmark date on the request for cancellation provided such date is legible and is not a postage meter date.

(3) If neither (1) or (2) above apply, the date and time the request is received by the company or its agent.”

Note that condition number (3) only applies when conditions (1) and (2) are not fulfilled.

In other words, Mercury is required by the cancellation clause to honor the cancellation date requested by the policyholder provided there is no postmark date. If Mercury refuses to do so, it is culpable of unilaterally reforming the policy contract.

A review of policy file number AP 04156003 revealed that Mercury is not honoring policyholder requests to backdate the cancellation of the non-owned automobile liability coverage. In the case of this file, the policyholder submitted a request to his producer for a January 1, 1998 backdated cancellation. Mercury refused to honor the policyholder's request, and instead terminated his policy as of its January 25, 1998 expiration date. Later, Mercury changed the termination date to January 15, 1998, which was the date that the producer received the policyholder's cancellation request.

Mercury's unilateral reformation of the cancellation clause denied the policyholder the premium refund that he is guaranteed under the policy contract. The reformation therefore violated CIC Section 1861.05(a) and is censurable under CIC Section 790.06.

In response to this finding, management stated: “We will amend the cancellation clause by eliminating (2) and changing (3) to read: ‘The date and time the request is received by the company or its agent.’ ...Until the insurance policy is amended, we agree that the cancellation clause should be honored as it is written.”

B. Contrary to CIC Section 11580.15, Mercury's discount notice does not mention Mercury's persistency, anti-theft, and California Medical Association discounts. It is therefore likely that some of the policyholders who qualify for these discounts are not receiving them, a violation of CIC Section 1861.05(a).

Management has agreed to include a description of the persistency, anti-theft, and California Medical Association premium credits in the discount notice.

C. Mercury's Basic Policy Information Processing computer screen includes a space for recording the insured's national origin. The inclusion of the national origin information on a computer screen that is readily accessible by the underwriters could raise questions about the legality of Mercury's personal automobile policy cancellation and non-renewal decisions under CCR Section 2632.19 and CIC Sections 1861.05(a), 1861.03(c)(1), and 11628(a).

In response to this finding, management agreed to block out the national origin information on the computer screen.

7. Personal package policies are comprised of personal automobile and homeowners insurance, and may include umbrella coverage as well. This being the case, the MCC-initiated personal package policy terminations are sometimes based on reasons that are extraneous to the State-sanctioned personal automobile cancellation/non-renewal reasons listed in CIC Section 1861.03(c)(1). Because MCC has not been offering to write monoline personal automobile coverage for insureds when it terminates their package policies for non-CIC Section 1861.03(c)(1) reasons, the company has been violating CIC Section 1861.03(c)(1) as well as the CIC Section 1861.02(b)(1) "all comers" provision.

In response to this finding, management stated:

"When a package policy has been cancelled, but the monoline auto policy

would still be acceptable, a solicitation will be made to the producer for a new auto policy application. Of course, all good drivers would be acceptable for a personal auto policy.”

Management’s proposal implies that MCC may decline to offer personal automobile coverage to a non-good driver who is technically eligible for coverage if the underwriter determines him to be “unacceptable.” However, MCC will be acting in violation of CIC Sections 1861.03(c)(1) and 1861.05(a) and CCR Section 2360.2 if it fails to offer personal automobile coverage to an eligible non-good driver. Management’s proposal therefore does not fully address MCC’s code violations.

This finding will be referred to the CDI Legal Division for review.

Mechanical Breakdown Program

The examination included a review of AMIC’s Mechanical Breakdown Program. The review showed that the rates and forms used by AMIC have been approved by the CDI.

APPLICATION OF RULES, RATES, AND FORMS

Ninety-seven in-force personal automobile policy files were reviewed. Of this total, five (5.2%) were cited for rating errors and two (2.1%) were cited for non-rating errors. No significant error trends were noted.

Because the 5.2% rating error ratio is not substantially excessive, it has not been identified as a high error ratio.

Declined, Canceled, or Non-Renewed Policies

The examination also included a review of 51 declined applications, 114 canceled monoline personal automobile policy files, and 60 non-renewed monoline personal automobile

policy files. Twenty-one (41%) of the declined applications and 28 (16%) of the 174 canceled/non-renewed policy files were cited for errors. Some declinations and terminated policy files were cited for more than one error. Descriptions of these findings are provided below.

Management has agreed to implement measures within 60 days of the examination report filing date to correct finding numbers 2, 6, 7, and 8. The remaining findings will be referred to the CDI Legal Division for review.

1. Mercury is responsible under CIC Section 1861.02(b)(1) and CCR Section 2632.12(b) for offering every good driver the option of signing a Driver Exclusion form to delete the non-good driver from the policy when the non-good driver's driving safety record or lack of driving experience constitutes the basis for Mercury's cancellation or non-renewal of the policy. The same holds true for declined applications. If Mercury declines to write an application due to a non-good driver's driving safety record or lack of driving experience, it must offer the good driver the option of excluding the non-good driver.

Generally, Mercury's underwriters ask the producers to forward driver exclusion offers to the good drivers on Mercury's behalf, but not always. Sometimes, the underwriters assume that the producers will extend the driver exclusion offers to the good drivers without being asked. In these latter situations, there is no documentation in Mercury's files to show whether the offers were ever made. In the absence of such documentation, it is assumed that Mercury has not been complying with CIC Section 1861.02(b)(1) and CCR Section 2632.12(b).

Four (2.3 %) of the 174 terminated policy files and 11 (21.6 %) of the 51 declined application files that were reviewed did not contain driver exclusion offer documentation. (For

purposes of confidentiality, the company files are not listed in this examination report. The files were identified under item 3(C) on pages 6 and 7 of the CDI's May 5, 1998 letter to company management.)

In response to this finding, management stated the following:

"CCR Section 2632.12(b) states: 'If a good driver -- is not eligible to purchase a good driver discount policy because of the driving safety record or years of driving experience of any other person, then the good driver shall be eligible to purchase a good driver discount policy which excludes such other person from coverage.' We do not refuse to write such risks. I find no authority in the CIC or CCRs which imposes any other requirement on insurers."

This finding is unresolved and will be referred to the CDI Legal Division for review.

2. The underwriters' cancellation/non-renewal reasons were omitted from eight (4.6%) of the 174 terminated policy files that were reviewed. Likewise, the underwriters' declination reasons were missing from nine (17.6%) of the 51 declination files that were reviewed. The omission of this underwriting information from the files violated the CIC Section 1857 recordkeeping mandate. (For purposes of confidentiality, the company files are not listed in this examination report. The files were identified under item 3(E) on pages 7 and 8 of the May 5, 1998 letter to management.)

In response to this finding, management stated the following:

"...We agree that providing the cancellation/non-renewal reasons should be shown. We will so instruct our underwriters."

3. Management audits personal automobile policy files for policy issuance, monetary, coverage, and documentation errors. For each error found, management assesses the number of demerit points that are prescribed for that error by Mercury's Audit Error Listing. The number of points assessed for an error can be as low as three and as high as seven, depending upon the

severity of the error.

The January 15, 1998 Mercury Audit Listing assigns six points, the second highest number of demerit points, for an underwriter's failure to decline an application "even though the risk is technically acceptable according to the manual" because the "underwriter's judgment should have caused the risk to be declined." The only other act for which management assesses more than five points is the underwriter's issuance of a policy to a technically unacceptable risk. Seven points are assessed for this latter error.

Clearly, underwriters receive a relatively high number of demerits for issuing policies for risks that are not disqualified by the manual's ineligibility criteria, but which are nevertheless deemed by management to be "unacceptable." Mercury's reliance upon the underwriters to individually determine the acceptability of technically eligible risks is a direct violation of CCR Section 2360.2. Moreover, this practice results in some risks being written while similarly-situated risks are not. Such acts of unfair discrimination violate CIC Section 1861.05(a) and are censurable under CIC Section 790.06.

Eleven (21.6%) of the 51 declinations reviewed had been issued to applicants who were technically eligible to purchase personal automobile insurance under Mercury's eligibility guidelines. (For purposes of confidentiality, the declination files are not listed in this examination report. The files were identified under item 3(F) on page 8 of the CDI's May 5, 1998 letter to company management.)

In response to this finding, management stated the following:

"Our underwriters use their judgement in accepting risks unless the rejection would violate some statute or regulation. We believe it is lawful to accept some...and decline others so long as the applicant is not a good driver and we do not violate CIC Section 11628(a)...."

This finding is unresolved and will be referred to the CDI Legal Division for review.

Additional information concerning Mercury's declination practices was provided in the foregoing "Adopted Rules, Rates, and Forms" section of this report under finding numbers 1(A), 1(B), 1(D), and 1(F).

4. Mercury also encourages the underwriters to exercise independent judgement when determining the acceptability of existing insureds. This practice results in the non-renewal of risks that still qualify for coverage under Mercury's guidelines, and therefore violates CCR Section 2360.2. Moreover, since Mercury can not ensure that each underwriter's deviation from its guidelines will be consistently administered by the other underwriters to all similarly-situated risks, the deviations as a whole are inequitable, and therefore violate CIC Section 1861.05(a). The deviations are also unlawful under CIC Section 1861.03(c)(1) insofar as CCR Section 2632.19(c)(1) predicates legal non-renewal upon the insured's ineligibility under Mercury's underwriting rules. Pursuant to CCR Section 2360.2 and CIC Sections 1857 and 1861.05(a), such underwriting rules must be written and can not be unfairly discriminatory.

Three (5%) of the 60 non-renewed policy files reviewed were still eligible for coverage when they were terminated. (For purposes of confidentiality, the files are not listed in this examination report. The files were identified under item 3(G) on page 9 of the CDI's May 5, 1998 letter to company management.)

In response to this finding, management stated the following:

"Our underwriters use their judgement in accepting risks unless the rejection would violate some statute or regulation...."

This finding is unresolved and will be referred to the CDI Legal Division for review.

5. Certain underwriting instructions that appear on the underwriters' memos to the producers are unfairly discriminatory insofar as they set pre-conditions that are more restrictive than the CIC Section 1861.02(b)(1) all comers provision and/or preclude the possibility of the individual's re-applying for a non-good driver policy when he becomes eligible to do so. Five examples of such instructions that were sent to producers for policies being terminated or applications being declined are: "Please do not resubmit until good driver," "Do not resubmit before the millennium," "Do not write David until he is a good driver," "Do not resubmit, ever," and "Do not submit unless all drivers are good drivers."

Ten (5.7%) of the 174 terminated policies and 12 (23.5%) of the 51 declined application files that were reviewed contained these types of underwriting instructions. (For purposes of confidentiality, the files are not listed in this examination report. The files were identified under item 3(D) on page 7 of the CDI's May 5, 1998 letter to company management.)

The instructions are based on the underwriter's estimate of the date when the individual will be considered "acceptable." Because Mercury underwrites for acceptability, the resubmission date set by the underwriter can occur on or some time after the date when the individual becomes eligible for insurance under Mercury's written guidelines.

By basing resubmission dates on unwritten acceptability criteria, Mercury is denying coverage to individuals once they are qualified to apply for it. In so doing, Mercury is violating CCR Section 2632.2 and CIC Sections 1861.02(b)(1) and 1861.05(a). This problem was criticized on page 27 of the 1994 California Rating and Underwriting Examination Report.

In response to this finding, management stated the following:

"CCR Section 2632.2 is titled Rating Errors. CIC Section 1861.05(a) refers only to rates. CIC Section 1861.02(b) simply says we shall not refuse to offer and sell a good driver discount policy to an eligible good driver. We have not

violated these provisions. However, so there is no confusion, we will instruct our underwriters to simply write "Do not submit this risk until the risk qualifies as a good driver."

The underwriting instructions proposed by management would preclude a non-good driver from re-applying for coverage once he becomes eligible to do so under Mercury's guidelines. The proposal is therefore inconsistent with CCR Section 2632.2 and CIC Section 1861.05(a).

This finding is unresolved and will be referred to the CDI Legal Division for review.

6. Mercury has not incorporated the CCR Section 2632.19, "Substantial Increase in Hazard Regulations," based non-renewal criteria into its underwriting manual. The omission of such criteria from the manual has apparently resulted in some confusion amongst the underwriters, as some are citing CCR Section 2632.19 as their basis for non-renewing risks that are still eligible for coverage under Mercury's guidelines, while other underwriters are citing Mercury's guidelines as their basis for non-renewing risks that are still eligible for coverage under CCR Section 2632.19. Either way, Mercury is violating CIC Sections 790.06, 1861.03(c)(1), and 1861.05(a).

Eight (13.3%) of the 60 non-renewed policy files reviewed were terminated unlawfully. (For purposes of confidentiality, the files are not listed in this examination report. The files were identified under item 3(H) on page 9 of the CDI's May 5, 1998 letter to company management.)

In response to this finding, management stated: "We will add CCR Section 2632.19 to our underwriting manual."

7. Two (1.8%) of the 114 cancelled policies reviewed were cited because Mercury had not honored the insureds' requests to cancel their policies as of the date of the producers' receipt

of their cancellation requests. Instead, Mercury changed each insured's requested cancellation date to the date when it received the cancellation request from the producer. In so doing, Mercury violated the policies' cancellation clause, which states that the cancellation effective date may be set as early as the date that the cancellation request is received at the producer's office. (For purposes of confidentiality, the files are not listed in this examination report. The files were identified under item 3(I) on page 9 of the CDI's May 5, 1998 letter to company management.)

In response to this finding, management stated: "We agree that we should use the date received at the producer's office and that the policy cancellation clause needs revision."

8. The policy's cancellation clause states that the unearned premiums of policies that are cancelled for non-payment are to be calculated on a short-rate basis. In practice, however, Mercury has been applying this contractual requirement only to its full pay, two-pay, and financed policies, and not to its three-pay policies, for which it uses a pro-rata calculation. Given that the difference between the short rate and pro rate factors is 10%, Mercury's exemption of three-pay policies from the policy's short rate requirements is unfairly discriminatory and violates CIC Section 1861.05(a).

For correction, management will instruct its employees to follow the policy's short rate requirements.

9. Mercury mails notices of cancellation for non-payment of premium 11 days prior to the cancellation effective date. The 11-day elapse time is insufficient to ensure that policyholders are given the full 10-day advance notice of cancellation that is required by CIC Section 662. Mercury needs to amend its mailing procedure so that it mails the notices no

later than 13 or 14 days prior to the cancellation date, depending upon whether the notices are being mailed over the weekdays or over the weekend, respectively.

In response to this finding, management stated the following:

“We believe we are following CIC Section 662.... We believe that the phrase ‘mailed or delivered’ (that appears in CIC Section 662) applies to both the 20 days and the 10 days (notice of cancellation).”

This finding is unresolved and will be referred to the CDI Legal Division for review.

Description of Errors

The following tables display the rating and non-rating errors that were discovered during the course of the personal automobile policy review. Premium overcharges and undercharges are listed under the column headings “OC” and “UC,” respectively.

TABLE OF RATING ERRORS

<u>NO.</u>	<u>CO.</u>	<u>POLICY NO.</u>	<u>PREMIUM(\$)</u>	<u>OC(\$)</u>	<u>UC(\$)</u>	<u>ERROR DESCRIPTION</u>
1.	MCC	27084801	\$ 1,366	\$	\$ 94	Incorrect vehicle usage code.
2.	MIC	04186011	1,118	41		Incorrect vehicle usage code.
3.	MIC	04188514	1,857	284		Incorrect vehicle usage code.
4.	MCC	06187609	775	148		Surcharge applied for non-chargeable accident.
5.	MIC	06185701	<u>5,527</u>		<u>43</u>	Incorrect vehicle symbol.
Totals			<u>\$10,643</u>	<u>\$473</u>	<u>\$137</u>	

TABLE OF NON-RATING ERRORS

NO. CO. POLICY NO. PREMIUM(\$) ERROR DESCRIPTION

1.	MCC	04193940	\$ 832	The named insured was listed as an excluded driver.
2.	MIC	02070704	<u>299</u>	Incorrect vehicle usage code.
	Total		<u>\$1,131</u>	

CALIFORNIA AUTOMOBILE ASSIGNED RISK PROGRAM

ADOPTED RULES, RATES, AND FORMS

Rate pages edition date: June 1, 1995

The applications that the Mercury Insurance Companies receive from the California Automobile Assigned Risk Plan (CAARP) are underwritten and rated by CAIC. In the fourth quarter of 1997, the CDI met with representatives of CAIC to discuss certain procedures that the company had adopted for underwriting and rating assigned risk automobile applications. The agreements reached as a result of that meeting were as follows:

1. CAIC may cancel an assigned risk automobile policy if it does not receive a valid driver's license and vehicle registration form from the insured within the first 60 days of coverage.
2. CAIC may only cancel an assigned risk automobile policy for the insured's failure to respond to its request for a telephone interview if the insured's application contains deficient or ambiguous information that prevents the company from being able to properly underwrite and rate the insured's exposure.
3. If CAIC learns that there are licensed drivers residing in the insured's household who have not been added or excluded from the assigned risk automobile policy, it will send a notice to the insured advising him that he has 15 days from the date of mailing to correct said application defect. If the insured then fails to add or exclude the licensed drivers from coverage, CAIC may cancel his policy on the basis of CIC Section 11624.1.
4. Pursuant to CIC Section 11624.1, CAIC may not charge for an accident disclosed on a telephone survey or a CLUE report until 15 days after it has sent notice to the insured that he will

be charged for said accident if he does not provide proof of non-fault.

5. CAIC will provide assigned risk automobile insureds with a toll-free telephone number for contacting its telephone survey center. The company will also extend the center's hours of operation to 7 P.M. Monday through Thursday, and 6 P.M. on Friday.

The examination included an audit of CAIC's in-force and terminated policy files. The review provided tangible proof that CAIC has been complying with agreements 2 and 4. Further discussion with CAIC management confirmed that the company has been complying with agreements 1, 3, and 5, as well.

The examination also showed that CAIC's other underwriting and rating procedures are consistent with CAARP manual rules and applicable State statutes.

APPLICATION OF RULES, RATES, AND FORMS

Twenty-five in-force policy files were reviewed. Of this total, one file (4%) was cited for a rating error and two files (8%) were cited for non-rating errors.

As stated on page 14 of this examination report, the high non-rating error ratio is deemed to be a violation of the CIC Section 1861.05(a) unfair rate discrimination prohibition.

The non-rating errors are attributed to CAIC's failure to a) revise a classification code to reflect a change in an insured's work commute and b) update a MVR at renewal.

CAIC has implemented the following procedural changes to prevent future occurrences of these errors:

1. CAIC has amended its questionnaire to request that the insured report the distance that he commutes to work.
2. CAIC has upgraded its audit system to ensure that MVRs are ordered at renewal.

Declined, Canceled, or Non-Renewed Policies

Thirteen canceled and ten non-renewed policy files were also reviewed. There were no errors found in these files.

There were no declination files available for review.

Description of Errors

The following tables display the rating and non-rating errors that were discovered during the course of the assigned risk automobile policy file review. The premium overcharge that resulted from the one rating error is listed under the column heading, "OC."

TABLE OF RATING ERRORS

NO. POLICY NO. PREMIUM(\$) OC(\$) ERROR DESCRIPTION

1.	102709409	<u>\$1,263</u>	<u>\$40</u>	The insured was charged for a traffic violation for which he had not yet been convicted.
	Totals	<u>\$1,263</u>	<u>\$40</u>	

TABLE OF NON-RATING ERRORS

NO. POLICY NO. PREMIUM(\$) ERROR DESCRIPTION

1.	10260807	\$1,912	The risk was misclassified.
2.	10260602	<u>956</u>	The MVR was not ordered when the policy was renewed.
	Total	<u>\$2,868</u>	

COMMERCIAL AUTOMOBILE

ADOPTED RULES, RATES, AND FORMS

Rates filed: October 7, 1996

Rate pages edition: January 1, 1997

Commercial automobile business is written in MCC. The rating plan is based on company-developed rates and rules. MCC offers three rating plans for the commercial automobile program with eligibility based on the following criteria. Policy type 2, the most preferred tier, caters to drivers age 70 or less, no more than one point in the last 12 months, no more than two points in the last three years, no more than one at-fault accident in the last three years, applicants with prior liability insurance for the past 12 months, and drivers not requiring a SR-22. Policy type 3 will allow a driver with two points in the last 12 months and three points in the last three years. Policy type 4, the least preferred, caters to drivers age 75 or less, no more than two accidents in the past three years, no more than three points in the last 12 months, and no more than seven points in the last three years. All applicants with employees must carry workers' compensation insurance. General liability coverage is required if the applicant's vehicle has attached equipment used in his business or if the applicant's vehicle is towing a trailer with permanently attached equipment. Applicants who have been in business less than two years are not eligible for liability limits in excess of \$100,000/\$300,000.

The examination disclosed that several aspects of MCC's commercial automobile program are inconsistent with California insurance statutes. Management has agreed to resolve all findings except item numbers 8 and 10 and, unless stated otherwise in this report, will implement the needed corrections no later than 60 days after the examination report filing date.

The unresolved findings will be referred to the CDI Legal Division for review.

A description of the examination findings is presented below along with a summary of management's written reply.

1. MCC offers a schedule rating plan for those risks that exceed \$7,500 in manual premium and have been in business for at least two years. However, the schedule rating plan adopted by the company differs from the one on file with the CDI in the following manner:

- a) The adopted rating plan does not reflect "premises" as a risk characteristic.
- b) The "management" risk characteristic under the adopted rating plan has been modified to reflect the parameter of "loss experience" in place of "experience."
- c) The adopted rating plan reflects a credit rating plan with fixed factors, while the filed rating plan reflects a true schedule rating plan with ranges of credits and debits.
- d) The rating plan used by the company fails to specify a maximum allowable credit/debit of 25% on the rating worksheet as specified in the filing.

In response, MCC has filed an objective rating plan to replace the current schedule rating plan. This rating plan was filed with the CDI on October 21, 1998.

2. The adopted rating plan uses fixed factors that are reflective of a credit rating plan, not a schedule rating plan. Thus, the rating plan implemented by the company is misleading in its identification as a schedule rating plan, which contemplates judgement through its use of ranges of both credits and debits. The failure of the company to properly apply the rating plan as it was intended and filed is a violation of CIC Sections 1861.01(c) and 1861.05(a).

As indicated above, the company filed a revised rating plan on October 21, 1998.

3. In calculating the three-year loss ratio for credit consideration for "loss experience" in the schedule rating plan, MCC was allowing either written premium or earned premium to be used for determining loss ratio. Consequently, depending on the information accepted by the

company, the derived loss ratio could result in a greater or lesser schedule credit. This practice allows for inconsistency and is considered unfairly discriminatory, a violation of CIC Section 1861.05(a). Furthermore, loss ratios are developed on the basis of earned premium, only.

In response, the company will use earned premium solely for determining loss ratio as reflected in the revised rating plan.

4. Policies experiencing a 90-day lapse or greater are not eligible for loss ratio credits under the schedule rating plan per the company's underwriting practice. However, this particular eligibility requirement is not included in the filed rating plan. The inconsistency in adopted versus filed guidelines has resulted in unfairly discriminatory rating, a violation of CIC Section 1861.05(a).

Management will incorporate the 90 day lapse rule in the revised rate filing.

5. The filed schedule rating plan reflects "cooperation" and "financial history" in addition to "experience" under the "Management" risk characteristic. However, MCC indicated that "cooperation" and "financial history" are not used in the consideration of credits. It was felt by management that these parameters are already reflected in the "loss experience," and therefore did not need separate treatment. The "loss experience" criterion the Company makes reference to is an unfiled, objective rating parameter. The filed schedule rating plan reflects "experience," not "loss experience" under the "Management" risk characteristic. Consequently, it should be management's experience that is considered, not their losses. The failure to apply the schedule rating plan as filed with the CDI constitutes the use of an unfiled rating plan, a violation of CIC Section 1816.01(c). This practice is also considered unfairly discriminatory, a violation of CIC 1861.05(a).

In response, MCC has resolved this issue in their development of an objective credit rating plan to replace the former schedule rating plan.

6. The schedule rating plan in effect uses an "expense/commission reduction" risk characteristic. This particular qualification is considered to be an objective rating parameter, and therefore is improperly reflected under the schedule rating plan. Expense/commission reduction is to be identified separately from the schedule rating plan as a fixed rating factor.

To resolve this issue, the company will discontinue the expense/commission reduction under the new rating plan.

7. The schedule rating plans, both the adopted and the filed, fail to provide parameters within each risk characteristic in the determination of credits or debits, which could result in dissimilar treatment of risks, a violation of CIC Section 1861.05(a).

In response, the MCC has resolved this issue in their development of an objective credit rating plan to replace the former schedule rating plan.

8. MCC's underwriting guidelines include restrictions and requirements with respect to eligibility for certain liability limits. However, management has stated that the company will invoke further judgement when considering whether to impose reduced limits of liability such as \$100,000/\$300,000/\$100,000, depending on the circumstances surrounding the risk. Thus, for a risk that may not be eligible for the \$1,000,000 combined single limit (CSL), but is still eligible for the \$600,000 CSL per written guidelines, the company may choose to offer only a limit of \$100,000/\$300,000/\$100,000. In response to one of our criticisms, MCC stated that, "The decision to offer lower limits is an underwriting judgement. This is based on the age, driver, and length of time licensed." The use of judgement in place of established guidelines allows for

dissimilar treatment among risks. MCC's practice of applying guidelines inconsistently is unfairly discriminatory and a violation of CIC Section 1861.05(a). MCC disagrees with this criticism and states the following:

"Our underwriters use judgement in determining the amount of exposure we will accept on a particular risk, unless prohibited by some statute or regulation. It is our position that Section 1861.05(a) applies only to rates not acceptability."

This issue is unresolved and will be referred to the CDI Legal Division for review.

9. The fleet rating plan adopted by the company does not mirror that which is on file with the CDI. Unlike the adopted rating plan, the filed rating plan fails to address how the policy type is to be determined, how the classes are to be used, the assignment of drivers, the rating of territories, the use of symbols, the radius of operations, and the rating of private passenger vehicles. The current rating plan in effect appears to be a modified version of a rating plan not previously filed. Additionally, there is no edition date reflected on the adopted rating plan, which is identified as "composite rating," to correspond to the filed fleet rating plan. The company stands in violation of CIC Section 1861.01(c) for its use of an unfiled rating plan.

In response, MCC has refiled the fleet rating plan, reflecting the additional information pertaining to policy type determination, class usage, private passenger vehicle rating, symbol usage, territories, and radius of operations.

10. In addition to the above parameters pertaining to fleet rating eligibility/rating, the fleet rating plan adopted by the company fails to define "good loss experience for past 3 years," "radius if over 50," and MVR qualifications for determining policy type and assignment of drivers. The lack of definitive guidelines and rating rules could result in unfair discrimination, a violation of CIC Section 1861.05(a).

MCC disagrees with this criticism and states the following:

“Our underwriters use their judgement in accepting some Fleets and rejecting others, unless the rejection would violate some statute or regulation. Note: It is Mercury’s position that CIC Section 1861.05(a) applies only to rates.”

This issue is unresolved and will be referred to the CDI Legal Division for review.

11. MCC’s underwriting guidelines concerning expired licenses state that, “Drivers with an expired license must provide proof of license renewal. If proof is not furnished within 14 days, the policy may be subject to cancellation or non-renewal.” However, contrary to manual guidelines, policies are being renewed with drivers having expired licenses. According to management, it is the company’s practice to allow for licenses to be expired for up to six months for renewal business. The inconsistency between written guidelines and company practice is considered unfairly discriminatory and a violation of CIC Section 1861.05(a).

The company responded by stating that,

“We will revise our underwriting rules to require proof of driver’s license renewal if it has expired in excess of 90 days from MVR order date. This will be for both new business and renewals.”

12. MCC has adopted the Private Passenger Fifteen Plus Program, which provides physical damage coverage on vehicles over 15 years old. All vehicles insured for comprehensive and collision coverage under this program must have liability coverage. It was found during the review that symbols for vehicles over 15 years old and with a market value in excess of \$6,500 were not reflected in the rating manual. The manual page states, “refer to company” for values in excess of \$6,500. Upon further inquiry, management did produce handwritten documentation showing a breakdown of symbols for values ranging from \$6,501 to \$20,000. However, there is no evidence that these symbols for vehicles over 15 years old had been filed with the CDI.

Management responded to our criticism by stating that, "Per our roll back agreement, everything prior to that was approved by the Department." MCC communicated to us that its understanding of rate filing procedures is that it is only required to file changes. And therefore, according to MCC, since these symbols were filed as part of the exemption filings, they are no longer required to be filed until a change in these symbols occurs. The CDI requires that all rate filings submitted for approval are to be complete in their entirety with respect to their rating plans. Consequently, symbols are considered to be a part of the rating plan, and therefore should be incorporated into the most current filed rating plan. The failure to file the symbols for the Fifteen Plus Program as part of the current rating plan is a violation of CIC Section 1861.01(c).

In response, MCC is filing symbols pertaining to vehicles over 15 years old in the proposed rate filing.

13. The classification code rules in the manual specifically state that, "the third digit represents distance to work or school." However, the review revealed a vehicle that was rated as business use, despite the fact that it was driven by a sixteen year-old to and from school less than 35 miles. In response to our criticism, management indicated that if a vehicle is registered to the corporation, it will always be rated as "business use or driven to work or school over 35 miles." The lack of clarification in the company's guidelines could result in unfairly discriminatory rating, which is a violation of CIC Section 1861.05(a).

In response, the company will amend the classification code rules to include corporate-owned vehicles as part of the third digit definition.

MCC has adopted the practice of "c-coding" policies that become ineligible for coverage per its underwriting criteria. This practice is similar to that which was found in the

personal automobile program. Thus, a c-coded policyholder, just as in the personal auto program, is restricted from purchasing additional limits or coverages or from adding vehicles or drivers. However, unlike the personal automobile program, procedures are in place to remove the c-coding once the issue is resolved and the risk is eligible once again. Typically under the commercial automobile program, policies that are c-coded are scheduled to be non-renewed; however, not all policies set to non-renew are c-coded. Consequently, the review revealed policies in which c-coding was waived, while in other instances, policies were not c-coded for failing to obtain required underwriting information. The lack of written guidelines pertaining to the application of c-coding has resulted in inconsistency and unfair treatment, a violation of CIC Section 1861.05(a).

MCC responded by stating the following:

“We only c-code when the information affects the acceptability, qualification, or rating of the policy. In the past, we did not want to penalize the insured mid-term for certain information not received. But from now on, we will c-code all risks set to non-renew.”

15. It was discovered during the review that MCC is still accepting older applications dated January 1994 that display the request for the applicant's country of birth and residency in the United States and California. The January 1994 application fails to specify that the above information is obtained solely for marketing or research purposes, as stipulated by CIC Section 791.05. Newer applications in effect since October 1994 have addressed this issue, and therefore should be used consistently by all producers. This issue is a repeat criticism from the prior exam report.

In response, management has distributed new applications as of June 1998. Obsolete forms have been destroyed.

APPLICATION OF RULES, RATES, AND FORMS

Forty-nine commercial automobile policies were reviewed, resulting in eight rating errors and fourteen non-rating errors. The high rating error ratio (16.3%) and high non-rating error ratio (28.6%) are discussed on page 14 of this exam report.

Four of the eight rating errors (50%) reflected incorrect schedule credits relative to the adopted rating plan, resulting in unfairly discriminatory rating, a violation of CIC Section 1861.05(a).

The number of errors involving incorrect credits will be minimized with the revised credit rating plan.

Five of the fourteen non-rating errors (35.7%) involved a lack of schedule rating consideration for risks that were eligible per the company's guidelines. These policies lacked the required schedule rating worksheet acknowledging consideration of credits/debits for one or more years. The lack of consideration of credits/debits for eligible risks is unfairly discriminatory, a violation of CIC Section 1861.05(a). The lack of documentation is a violation of CIC Section 1857.

To resolve this issue, a system edit will be developed requiring underwriters to verify credits when policy premiums exceed \$7,500.

Declined, Canceled, or Non-Renewed Policies

One declination, thirty-three cancellations, and 25 non-renewals were reviewed. The review of declinations was limited, in that, most policies were submitted on a bound basis. Consequently, any bound submissions that did not qualify for coverage resulted in cancellation. The one declination reviewed was a non-bound submission.

The one declination reviewed lacked sufficient information to support the basis for declination. The policy in question was declined due to the number of units of insulin taken for a diabetic and a recent accident. However, the company failed to base its underwriting decision on a medical report, which the applicant was in the process of securing, in accordance with company guidelines. The lack of documentation to support the basis for the declination is a violation of CIC Section 1857. The failure to apply established guidelines consistently is unfairly discriminatory and a violation of CIC Section 1861.05(a).

In response, MCC states the following:

"I do agree that a medical report should have been obtained and given consideration prior to our decision. Henceforth a medical examination will be obtained on all insulin dependent diabetics. Medically impaired risks will be accepted, provided they have been approved by their doctor."

One policy was canceled due to driving record; however, the driving record in question still qualified for MCC's highest rated tier, Policy Type 4. The failure to underwrite in accordance with company-established rules has resulted in unfair discrimination, a violation of CIC Section 1861.05(a).

MCC disagrees with this criticism and states the following:

"Our underwriters use their judgement in accepting risks, unless the rejection would violate some statute or regulation. We believe it is lawful as long as we do not violate CIC Section 11628(a)."

This issue is unresolved and will be referred to the CDI Legal Division for review.

MCC failed to rescind a non-renewal whereby one of the at-fault accidents was subsequently deemed non-chargeable. The failure to underwrite in accordance with company-established rules has resulted in unfair discrimination, a violation of CIC Section 1861.05(a).

MCC has acknowledged this error, but adds the following statement:

“We do not believe that existing law prohibits the use of underwriting judgement in determining acceptability of risks who are not specifically protected, provided we do not violate CIC Section 11628(a) which we do not. It is our position that CIC Section 1861.05(a) refers only to rates, not acceptability.”

Description of Errors

The tables below and on the following page show the rating and non-rating errors discovered in the course of the commercial automobile policy file review. Overcharges and undercharges are displayed in the columns "OC" and "UC," respectively.

TABLE OF RATING ERRORS

<u>NO.</u>	<u>CO.</u>	<u>POLICY NO.</u>	<u>PREMIUM(\$)</u>	<u>OC(\$)</u>	<u>UC(\$)</u>	<u>ERROR DESCRIPTION</u>
1.	MCC	AC11026575	\$11,994	\$	\$196	Incorrect schedule modification (17% credit).
2.	MCC	AC11027429	9,194	662		Incorrect schedule modification (10% credit).
3.	MCC	AC11016152	9,501	287		Incorrect schedule modification (3% credit).
4.	MCC	AC11009442	7,767	698		Incorrect schedule modification (14% credit); incorrect radius factor.
5.	MCC	AC11028404	8,836	300		Incorrect policy/tier placement; failure to schedule rate.
6.	MCC	AC11019904	1,564		78	Incorrect vehicle symbol.
7.	MCC	AC11021110	10,144	263		Incorrect vehicle symbol.
8.	MCC	AC11027547	<u>3,523</u>	<u>39</u>	<u> </u>	Failure to apply multi-car discount.
Totals			<u>\$62,253</u>	<u>\$2,249</u>	<u>\$274</u>	

TABLE OF NON-RATING ERRORS

<u>NO.</u>	<u>CO.</u>	<u>POLICY NO.</u>	<u>PREMIUM(\$)</u>	<u>ERROR DESCRIPTION</u>
1.	MCC	AC11026575	\$ 11,994	No schedule rating worksheet in file (20% credit).
2.	MCC	AC11028404	8,836	No schedule rating worksheet in file.
3.	MCC	AC11027809	7,836	No schedule rating worksheet in file.
4.	MCC	AC11009442	7,767	No schedule rating worksheet in file.
5.	MCC	AC11027807	8,442	No schedule rating worksheet in file.
6.	MCC	AC71123214	18,997	Failure to non-renew; failure to obtain loss runs.
7.	MCC	AC11028247	20,118	Incorrect territory.
8.	MCC	AC11028728	1,245	Incorrect accident fault assessment.
9.	MCC	AC11016257	2,509	Incorrect accident fault assessment.
10.	MCC	AC11019827	10,510	Ineligible for policy/tier placement.
11.	MCC	AC11027900	437	Incomplete application/underwriting information.
12.	MCC	AC11028931	577	Not all business use vehicles were placed with MCC per guidelines.
13.	MCC	AC11028706	5,235	Incorrect rating information; incorrect date first licensed.
14.	MCC	AC11027425	741	Risk ineligible due to less than two years in business.
Total			<u>\$105,244</u>	

COMMERCIAL MULTIPLE PERIL

MCC writes commercial multi-peril policies through seven distinct programs. The programs consist of the following: Metalworkers, Printers, Lessor's Risk, Apartments, Mercantile, Offices, and Woodworkers. Refer to individual program headings for specific issues.

Underwriting Results

The following table shows the underwriting results for each program for the 1997 calendar year:

<u>Program</u>	<u>Earned Premium</u>	<u>Incurred Losses</u>	<u>Loss Ratio</u>
Metalworkers	\$4,719,677	\$1,126,182	23.9%
Printers	2,279,039	686,289	30.1
Lessor's Risk	1,370,562	388,252	28.3
Apartments	351,755	31,409	8.9
Mercantile	92,715	28,736	30.1
Offices	216,334	42,445	45.8
Woodworkers	<u>13,487</u>	<u>0</u>	<u>0.0</u>
Totals	<u>\$9,043,569</u>	<u>\$2,303,313</u>	<u>25.5%</u>

COMMERCIAL MULTIPLE PERIL PROGRAMS

ADOPTED RULES, RATES, AND FORMS

Rates approved: May 23, 1997

Rate pages edition date: June 1997

MCC caters to businesses located in protection classes 1 through 8, applicants with less than one claim, buildings built 1960 or later (unless updates were made), and a minimum \$500 policy premium. The company also offers an individual risk premium modification (IRPM) rating plan for risks with a minimum premium of \$2,000.

The examination disclosed that several aspects of MCC's commercial multiple peril programs are inconsistent with California insurance statutes. Management has agreed to resolve all the findings and, unless stated otherwise in this report, will implement the needed corrections no later than 60 days after the examination report filing date.

A description of the examination findings is presented below along with a summary of management's reply.

The guidelines used to determine eligibility for MCC state that, "Applicants declined, cancelled, or non-renewed for cause in the last three years by the previous insurance company are not eligible." The decision to decline business must be in accordance with MCC's own established underwriting rules, not those developed by a previous insurer. Thus, declining business on the basis of previous adverse underwriting decisions violates CIC Section 791.12.

To resolve this criticism, MCC has revised the eligibility guideline. All applicants declined, canceled, or non-renewed for cause in the last three years by another company may now be eligible for coverage. If the risk was canceled or non-renewed due to prior claims experience,

the risk is to be submitted non-bound.

The underwriting manual states that, "All businesses must have double cylinder dead bolt locks, unless prohibited by the fire department and/or local ordinances or building ownership."

There was evidence that documentation was not maintained pertaining to this eligibility requirement. To ensure consistency in the application of guidelines, it is imperative that the company maintains appropriate documentation to support a deviation from the above guideline.

The lack of documentation is considered a violation of CIC Section 1857.

In response, MCC states the following:

"In the natural progression of situations, we believe it is easy to understand that the presence of a central station alarm is greater than the requirement of at least a double dead bolt lock. The fact that the underwriter did not document the presence of a central station alarm as being greater than the requirement of a double dead bolt lock has no bearing on the rate or risk acceptability, nor does it add or detract from the requirement of maintaining reasonable records as defined in CIC Section 1857."

Management has expressed that appropriate documentation will be maintained in the future in regards to waiving dead bolt locks with the presence of a central station alarm.

The underwriting manual contains a similar provision which states that, "Other alarm safeguards may be required, like a central station alarm, based on a specific business or values insured." The guidelines must be more definitive as to what businesses or values insured will require such protection to ensure consistency. The lack of definitive guidelines could result in unfair discrimination, a violation of CIC Section 1861.05(a).

In response to this finding, management has amended the underwriting guidelines to state that a central station alarm is required when the value of contents is \$750,000 or greater.

The underwriting manual states, "Optional Coverages Not Otherwise Classified – Refer To The Company For Rating." Management indicated that MCC will accommodate a risk by providing specialized coverage and a corresponding rate developed by underwriting in order to retain an account. The CDI's position is that all rates executed by a company must be filed and approved prior to their use. The company's intent to preserve retention through accommodation and judgmentally-derived rates allows for unfairly discriminatory rating, a violation of CIC Section 1861.05(a).

To resolve this criticism, MCC has removed the statement relating to "Optional Coverages Not Otherwise Classified" from the underwriting manual. In addition, the company has filed a general rate for property per \$100 of insurance value, and for liability coverage, a minimum premium of \$100 for any optional property or liability coverage not separately listed under the optional coverage section.

The underwriting manual fails to specify acceptable timeframes for updates regarding roofs, wiring, and plumbing. Consequently, some risks may be declined despite having been updated, while other risks may be issued without the updates. This practice can be considered unfairly discriminatory, a violation of CIC Section 1861.05(a), in that it allows for dissimilar treatment of similar risks.

In response, management states the following:

"We have changed the building age acceptability from 1975 to 1960. This should eliminate the problems on the exceptions made on older buildings prior to 1975. We will also accept buildings built prior to 1960 that have plumbing, roof, wiring and heating updates, as long as they meet any other underwriting guideline requirement."

The review revealed that the deductible for coverage options, including Errors &

Omissions, Transit Coverage, and Mechanical Breakdown, were not separately identified in the manual. As such, it would appear that the policy deductible would also apply to those individual coverages. Management indicated that since the deductible pertaining to the Section I property portion of the policy could sometimes be as high as the coverage itself, it was therefore company practice to apply a standard \$250 deductible. However, the review revealed inconsistency with various deductibles being applied. Also, the company stated that it would also accommodate an agent's request for a certain deductible without a change in premium. The lack of clear and concise rating rules has resulted in unfairly discriminatory rating, a violation of CIC Section 1861.05(a). Applying various deductibles without a corresponding rate change results in rates that are excessive or inadequate, also a violation of CIC Section 1861.05(a). The failure of MCC to file such deductibles pertaining to particular coverage options or coverage parts that are made a part of an amendatory endorsement is a violation of CIC Section 1861.01(c).

In response, MCC has expanded the deductible sections in the underwriting manual. The changes were part of the filing approved by the CDI on May 19, 1998.

It was noted during the review that the underwriting manual provides a replacement cost methodology for the Apartment Program on a cost per square foot basis. However, MCC has failed to formally adopt a methodology for determining replacement cost for the remaining applicable programs. The company indicated that Marshall & Swift data is utilized, as provided by the agents. However, it is not clear as to whether this information is current. The failure to formally adopt a methodology could result in unfair discrimination, which is a violation of CIC Section 1861.05(a).

To resolve this issue, MCC is updating the Marshall & Swift replacement cost data on a

CD-ROM, with print-out of data available by specific property location. The company began using this feature effective September 1, 1998.

Reference is made in the underwriting manual to commission reduction and its ineligibility to the Apartment Program. Absent any other rule stated in the manual, it could be concluded that commission reduction is, however, available in all remaining programs. However, there are no written rules pertaining to the application of commission reduction. The lack of such rules could result in unfairly discriminatory rating, which is considered a violation of CIC Section 1861.05(a). Furthermore, MCC has not filed any rating rules pertaining to commission reduction with the CDI, a violation of CIC Section 1861.01(c).

Management has agreed to file the rating rule pertaining to commission.

The IRPM rating plan adopted by the company reflects a credit rating plan, only specifying credits on the IRPM worksheet. However, the rating plan on file with the CDI makes reference to both credits and debits. The rating plan also fails to reflect an edition date ensuring that the most current filed rating plan is in effect. The "credit rating plan" adopted by the company constitutes the use of an unfiled rating plan, a violation of CIC Section 1861.01(c). The failure to apply the IRPM rating plan in accordance with the filed rating plan is considered unfairly discriminatory and a violation of CIC Section 1861.05(a).

In response, management has developed a revised IRPM worksheet that includes both credits and debits, similar to the worksheet on file with the CDI. The revised worksheet, reflecting a current edition date, will be submitted to the CDI as an addendum to the recent filing.

Metal Workers Program

The Metal Workers Program, MCC's largest commercial multi-peril program, caters to risks involved in copper, brass, steel, or aluminum type metals. Ineligibility includes the following: applicants working with magnesium, aluminum (atomized), aluminum - magnesium alloy or other exotic metals; electroplating or heat treating; applicants doing more than 10% welding; injection molding; and applicants designing or making a product. However, applicants doing work to the specifications of others (Job Shop) are eligible.

Printers Program

The Printers Program offers business personal property and manufacturers and contractors liability coverage to various eligible print shop occupancies. The policy includes a printers amendatory endorsement for an additional charge.

Lessor's Risk Program

MCC offers Lessor's Risk coverage for the following programs: Industrial Business Complexes, Shopping Centers, Office Buildings, and Single Occupancy Lessor's Risk. All buildings must be constructed after 1975 and have a \$1,000 minimum deductible. Earthquake coverage is not available. Ineligible risks would include buildings with a vacancy factor over 25%, buildings over two stories, and shopping centers with a rentable area over 25,000 square feet.

The underwriting manual states that the minimum deductible available for the Lessor's Risk Program is \$1,000. In addition, various deductible credits are available, including a credit for a \$1,000 deductible. The deductible credits do not distinguish between the Lessor's Risk

Program and all other programs. Management stated that the \$1,000 deductible under the Lessor's Risk Program is not eligible for a deductible credit since \$1,000 is the minimum deductible. It was further communicated that if an agent wanted a higher deductible for a lessor's risk, MCC would, as a practice, apply the percentage difference between the \$1,000 deductible credit and the desired higher deductible. This practice constitutes the use of an unfiled rate and/or rating rule, a violation of CIC Section 1861.01(c). The lack of clear and concise guidelines could result in unfairly discriminatory rating, a violation of CIC Section 1861.05(a).

In response, MCC has adopted a rule change relating to deductibles for the Lessor's Risk Program, which was filed and approved by the CDI on May 19, 1998.

The Lessor's Risk Program contains a guideline which states that, "Tenants must have their own property and liability insurance coverage and the building owner must be named as an additional insured on the tenants policy." Upon further inquiry with management, it was conveyed that this requirement is difficult to monitor. The inability to obtain this information on a consistent basis could result in unfair discrimination, a violation of CIC Section 1861.05(a).

In response, the company has agreed to reword the underwriting guidelines to state that tenants "should" have their own property and liability coverage and the building owner "should" be named as an additional insured on the tenant's policy.

The Lessor's Risk Program clearly states that risks are to be submitted non-bound. However, there was evidence throughout the review that risks were submitted bound and issued accordingly, contrary to company guidelines. The failure to follow guidelines consistently is considered unfairly discriminatory, a violation of CIC Section 1861.05(a).

In response, management states that there was not unfair discrimination against anyone eligible to purchase insurance. However, the agents were called on the above-mentioned risks and reminded that lessor's risks must be submitted non-bound.

Apartments Program

MCC offers apartment building coverage for risks constructed after 1975. Additional eligibility criteria include the following: 100% insurance to value at a cost of \$85 per square foot on one-story buildings, all risks must have smoke detectors, all buildings must have a vacancy rate less than 15%, and each unit must be at least 700 square feet. The Apartments Program carries a \$1,000 minimum deductible. Earthquake coverage is available on one to four unit habitational structures.

The policy review showed that MCC has failed to provide the California Residential Property Insurance Disclosure Statement on those risks that have one to four units in the Apartments Program, a violation of CIC Section 10101.

To resolve this criticism, MCC will reproduce the form used for personal lines dwelling fire and conform it for three and four family apartment houses.

Mercantile Program

The Mercantile Program offers coverage for various retail occupancies. Certain occupancies listed in the manual are ineligible.

The Mercantile Program offers a Comprehensive Plan that requires that all applicants be placed in Trade Group One. However, the manual displays rates under the Comprehensive Plan for both Trade Groups One and Two. Consequently, the manner in which the guidelines are

written contradicts the rate pages, and is therefore unfairly discriminatory, a violation of CIC Section 1861.05(a).

To resolve this criticism, the underwriting guidelines for the Mercantile Program have been replaced by the new Businessowners Program (BOP) approved by the CDI on May 19, 1998.

It was discovered during the course of the review that MCC has not established building rates for its Mercantile Program. Consequently, the company had adopted the building rates under the Print Shop Program to apply to the Mercantile Program. The failure to establish and file a separate building rate for the Mercantile Program is a violation of CIC Section 1861.01(c). Utilizing the building rate designed for the Print Shop Program could result in rates that are excessive, inadequate, or unfairly discriminatory, a violation of CIC Section 1861.05(a).

In response, MCC has established a separate building rate for the Mercantile Program (now the BOP Program), filed and approved by the CDI as of May 19, 1998.

Offices Program

The Offices Program offers business personal property, \$300,000 premises liability (OL&T), and \$1,000 medical payments coverage to eligible occupancies. Businesses operated from a residence or those requiring monoline general liability are not eligible.

Woodworkers Program

The Woodworkers Program offers coverage for business personal property and premises liability to eligible risks. New ventures or applicants working out of the home are ineligible.

APPLICATION OF RULES, RATES, AND FORMS

Forty-six in-force commercial property policy files were reviewed, resulting in five rating errors and twenty-three non-rating errors. The high non-rating error ratio (50%) is discussed on Page 14 of this report.

Eleven of the non-rating errors (47.8%) were due to the company's failure to apply the IRPM rating plan in accordance with company guidelines. For risks eligible for the plan, no evidence was present to indicate consideration for the plan. Management conveyed that the reason for no IRPM consideration and/or rating was that MCC's rates are already competitive. The purpose of IRPM rating is to recognize unique risk characteristics of a given risk, not to cater to market conditions or for compensating inadequate or excessive rates. The lack of IRPM worksheets violates the recordkeeping requirements of CIC Section 1857. The failure to apply the filed rating plan is considered unfairly discriminatory and a violation of CIC Section 1861.05(a).

In response, management states the following:

"We do not agree with the Department's conclusion relating to IRPM rating considerations as the Mercury plan is filed. In conversations with past Department of Insurance auditor's, it was our impression that the IRPM worksheets only needed to be completed when a risk was given IRPM credits. Each of the risks cited were given consideration and it was decided that none of the risks in question had unique characteristics qualifying the risk for IRPM credits. We will put a worksheet in every file."

The underwriting guidelines impose a 1975 restriction for year built with certain programs. The policy review uncovered six policies in which MCC failed to comply with the company-established guideline surrounding age restriction. These policies were ineligible for coverage. The inconsistent application of the age requirement has resulted in unfair treatment, a

violation of CIC Section 1861.05(a).

In response, the company has broadened the underwriting restriction to accommodate buildings built in 1960 or later. Any exceptions beyond this requirement will be appropriately documented.

Two of the five rating errors (40.0%) were the result of the sprinkler discount being applied inconsistently. This resulted in unfairly discriminatory rating, a violation of CIC Section 1861.05(a).

The company plans on automating the Commercial Property Department within the next eighteen months, which should reduce the number of rating errors.

Declined, Canceled, and Non-Renewed Policies

Twenty-seven declinations, twenty-three cancellations, and one non-renewal were also reviewed, which revealed that the company is not providing a sufficient reason for cancellation on the cancellation notice mailed to the insured. On those risks that were canceled for failing to meet the eligibility requirements, the company only stated "Company Election" on the cancellation notice. The failure to state the specific reason(s) for cancellation violates CIC Section 677.2(b).

Management agreed to this finding and will include a brief reason of cancellation on all future cancellation notices.

It was also discovered during the review that two policies were canceled for failing to provide a signed and dated audit report. However, the underwriting manual fails to provide parameters for requesting voluntary audits. The lack of such guidelines has resulted in dissimilar treatment of similar risks, a violation of CIC Section 1861.05(a).

In response, the company has added an addendum to the manual, defining the payroll amount subject to a voluntary audit.

Description of Errors

The tables shown below and on the following page show the rating and non-rating errors discovered in the course of the commercial multiple peril review. Overcharges and undercharges are displayed in the columns "OC and "UC, respectively.

TABLE OF RATING ERRORS

<u>NO.</u>	<u>CO.</u>	<u>POLICY NO.</u>	<u>PREMIUM(\$)</u>	<u>OC(\$)</u>	<u>UC(\$)</u>	<u>ERROR DESCRIPTION</u>
1.	MCC	M30523	\$1,397	\$	\$ 48	Applied unfiled rate for loss of earnings.
2.	MCC	M30425	869	70		Failed to apply sprinkler credit.
3.	MCC	M30426	1,161		93	Failed to delete sprinkler credit.
4.	MCC	M26614	1,882	76		Applied charge for legal liability
5.	MCC	M30872	<u>781</u>	<u>54</u>		Applied charge for legal liability.
Totals			<u>\$6,090</u>	<u>\$200</u>	<u>\$141</u>	

TABLE OF NON-RATING ERRORS

<u>NO.</u>	<u>CO.</u>	<u>POLICY NO.</u>	<u>PREMIUM(\$)</u>	<u>ERROR DESCRIPTION</u>
1.	MCC	M26445	\$ 1,161	Failed to perform voluntary audit.
2.	MCC	M26514	1,273	Failed to perform voluntary audit.
3.	MCC	M30523	1,397	Personal injury coverage not available in Machine Shop in Program.
4.	MCC	M30211	1,538	Lack of documentation noting discrepancy between inspection and application.
5.	MCC	M30459	500	Incorrect construction class.
6.	MCC	M26476	887	Incorrect inflation guard percentage applied.
7.	MCC	M30344	823	Risk is ineligible due to age of building.
8.	MCC	M30546	1,062	Risk is ineligible due to age of building.
9.	MCC	M30542	1,215	Risk is ineligible due to age of building.
10.	MCC	M30243	1,519	Risk is ineligible due to age of building.
11.	MCC	M30198	1,703	Risk ineligible due to age of building; incorrect zip code used.
12.	MCC	M26462	500	Risk is ineligible due to age of building; replacement cost below 100% minimum requirement; \$500 deductible is not available in the Apartment Program
13.	MCC	M30993	2,374	No schedule rating worksheet in file
14.	MCC	M26590	2,257	No schedule rating worksheet in file.
15.	MCC	M30962	2,979	No schedule rating worksheet in file.
16.	MCC	M28324	3,185	No schedule rating worksheet in file.
17.	MCC	M26576	2,211	No schedule rating worksheet in file.
18.	MCC	M30225	8,611	No schedule rating worksheet in file.
19.	MCC	M26709	3,195	No schedule rating worksheet in file.
20.	MCC	M26691	2,549	No schedule rating worksheet in file.
21.	MCC	M26500	7,016	No schedule rating worksheet in file.
22.	MCC	M26559	3,845	No schedule rating worksheet in file.
23.	MCC	M26323	2,883	No schedule rating worksheet in file.
	Total		<u>\$54,683</u>	

SUMMARY OF MAJOR EXAMINATION CRITICISMS

The following is a brief summary of the primary criticisms and the corresponding resolutions that were developed during the course of the 1998 Mercury Insurance Companies examination. In response to each criticism, the Companies are required to identify the resolutions and/or corrective actions that have been or will be taken to correct the deficiency and achieve compliance. The respective resolutions or actions follow each of the criticisms detailed here. Regardless of the resolutions or actions taken or proposed by the insurer in this report, it is the insurer's obligation to ensure that compliance is achieved and maintained. This report contains many unresolved issues, which will be referred to the Department's Legal Division for further review and action. Future resolutions or actions will be attached to this report via addendum.

	<u>Page</u>
<u>Method of Doing Business</u>	
1. The extent of Mercury's direction and control over the brokers in the submission of applications, Mercury's representation of the brokers as independent agents in its advertisements, and the binding authority that Mercury has invested in the brokers are altogether inconsistent with the CIC Section 1623 brokerage definition. Mercury's misrepresentation of these producers has resulted in violations of <u>CIC Sections 790.03(b), 1704(a), and 1861.05(a)</u> .	4, 11
This finding is unresolved and will be referred to the CDI Legal Division for review.	
<u>Homeowners Multiple Peril Program</u>	
2. MCC has been unilaterally reforming the deductible amounts on homeowners multiple peril policies when policyholders have incurred two or more losses. <u>CIC Sections 678 and 1861.05(a)</u>	18

Management has instructed the underwriters to wait until policy renewal to change the deductible.

3. The manual contains criteria that discriminate against individuals on the basis of their marital status. 19, 20
CCR Section 2560.3

The company will discontinue discriminating against individuals on the basis of their marital status:

4. An underwriting computer screen includes a space for recording the insured's national origin. 20
CIC Section 679.72

Management will block the national origin data field from the computer screen.

5. MCC has not adopted a procedure for removing c-codes after homeowners and personal package policy insureds have regained their eligibility. 21
CIC Sections 790.06 and 1861.05(a)

This finding is unresolved and will be referred to the CDI Legal Division for review.

6. MCC has not adopted a procedure by which to regulate the c-coding of homeowners and personal package policies. Without such a procedure, MCC can not ensure that the c-code is applied consistently and equitably among similar insureds. 21
CIC Sections 790.06 and 1861.05(a)

This finding is unresolved and will be referred to the CDI Legal Division for review.

7. If MCC is unable to conduct the standard telephone survey, it may cancel the insured's policy even if his application has been completed in its entirety. 22
CIC Section 1861.05(a)

This finding is unresolved and will be referred to the CDI Legal Division for review.

8. Correct earthquake premiums were recorded on only two (25%) of the eight Earthquake Acceptance/Rejection Offers that were reviewed.

23

CIC Sections 10081 and 10082

The company is training the producers to calculate the earthquake premiums correctly.

9. MCC waits until the insured has rejected the first and second earthquake insurance offers before it issues the first Notice of Non-Coverage for Earthquake.

24

CIC Section 10086.1

This finding is unresolved and will be referred to the CDI Legal Division for review.

10. MCC has not been providing insureds with a free-standing notice of earthquake insurance premium discounts.

24

CIC Section 10089.2

Management will develop a free-standing notice that discloses the available earthquake discounts.

11. The manual contains homeowners insurance eligibility criteria that are vague and ambiguous. The lack of definitive criteria promotes unfair discrimination.

28

CIC Sections 790.06 and 1861.05(a) and CCR Section 2360.2

This finding is unresolved and will be referred to the CDI Legal Division for review.

12. MCC cancels a new homeowners or personal package policy when it does not receive a signed Earthquake Acceptance/Rejection Offer from the insured.

29

CIC Section 10085

The company will discontinue this practice.

Personal Umbrella Program

13. MCC's umbrella occupation eligibility rule includes a list of 26 occupations that are labeled "U for unacceptable. The "U designations are unfairly discriminatory. CIC Sections 790.06 and 1861.05(a) 25

This finding is unresolved and will be referred to the CDI Legal Division for review.

14. MCC's umbrella occupational eligibility rule also includes a list of 6 occupations that are labeled "S for submit non-bound. By targeting these occupations for special review, MCC is failing to apply its underwriting criteria uniformly across all occupations. CIC Sections 790.06 and 1861.05(a) and CCR Section 2360.2 25

This finding is unresolved and will be referred to the CDI Legal Division for review.

15. MCC does not require its underwriters to write umbrella coverage for applicants who are diabetic, cardiovascular patients, or who suffer from some other medical condition if they qualify for coverage and have a satisfactory medical report. CIC Sections 790.06 and 1861.05(a) and CCR Section 2360.2 26

Management will adopt a written rule requiring that all medically impaired applicants submit a medical report. Applicants who submit a satisfactory report will be issued a policy.

16. The umbrella eligibility guidelines contain criteria that are ambiguous. The lack of definitive criteria promotes unfair discrimination. CIC Sections 790.06 and 1861.05(a) and CCR Section 2360.2 28

This finding is unresolved and will be referred to the CDI Legal Division for review.

Voluntary Personal Automobile Program

17. Mercury requires that the applications of artists, emergency vehicle operators, et cetera, be submitted non-bound. Some of the criteria that the company uses to evaluate these applications are unwritten. 34
CIC Sections 1861.05(a) and 11628(c) and CCR Section 2360.2

This finding is unresolved and will be referred to the CDI Legal Division for review.

18. The manual requires that the applications of non-good drivers employed in the military be submitted non-bound. No exemption is included in the manual for military personnel who are on active duty service in the United States Armed Forces. 35
CIC Section 11628(c)

This finding is unresolved and will be referred to the CDI Legal Division for review.

19. Mercury deletes the non-owned automobile coverage from the policies of good drivers who are employed in certain prescribed occupations. 36
CCR Section 2632.14

This finding is unresolved and will be referred to the CDI Legal Division for review.

20. The manual contains an ambiguous eligibility rule for individuals who are operating businesses at their homes. 38
CIC Sections 790.06 and 1861.05(a) and CCR Section 2360.2

This finding is unresolved and will be referred to the CDI Legal Division for review.

21. The manual states that students with less than 10 years' residency in the United States are ineligible for coverage. This rule discriminates against students on the basis of their national origin. 38
CIC Section 11628(a)

This finding is unresolved and will be referred to the Legal Division.

22. Mercury does not require its underwriters to write personal automobile coverage for applicants who are diabetic, cardiovascular patients, or who suffer from some other medical condition if they qualify for the coverage, are licensed to drive, and have a satisfactory medical report. CIC Sections 790.06 and 1861.05(a) and CCR Section 2360.2 39

This finding is unresolved and will be referred to the CDI Legal Division for review.

23. The manual states that Mercury may decline to write liability limits greater than \$15,000/\$30,000/\$10,000 for some non-good driver risks that satisfy two or more of the rule's criteria. The rule's ambiguity creates the potential for unfairly discriminatory underwriting decisions. CIC Section 1861.05(a) 41

This finding is unresolved and will be referred to the CDI Legal Division for review.

24. The manual states that in order for an insured to qualify as a good driver, he "must have been continuously licensed to drive a motor vehicle for the preceding three years with a valid U.S. or Canadian license for all of the last 18 months. The 18 month requirement is inconsistent with CCR Section 2632.13(D) and CIC Sections 1861.02(b)(1) and 1861.025(a). 42

This finding is unresolved and will be referred to the CDI Legal Division for review.

25. The manual states that an insured does not qualify for the good driver discount if he has had more than one violation point count. CCR Section 2632.13(a) and (B)(1). 42

Management agreed to amend the rule to disqualify an insured from receiving the good driver discount if he has had more than one violation point count conviction.

26. Mercury has expanded the three year timeframe for re-establishing good driver discount eligibility to seven years for insureds who have been convicted of violations referenced by CIC Section 1861.025(c). However, Mercury has not amended its filing to reflect this change. CIC Section 1861.05(b) 42

Management agreed to include this change in the filing that it is preparing to send to the CDI.

27. Mercury is waiving the last 30 days of the insured's age and years of driving experience for the purpose of establishing eligibility and computing premium, but has not amended its filing to reflect this procedure. CIC Section 1861.05(b) 43

Management will include the age and years of driving experience changes in the filing that it is preparing to send to the CDI.

28. Mercury automatically charges for any accident recorded on a CLUE report for which a claims reserve has been opened unless the CLUE report shows that the insured is not at fault, or that the reserve has been closed without payment. CCR Sections 2632:5(c)(1)(B) and 2632.13(a) and (f) 43

This finding is unresolved and will be referred to the CDI Legal Division for review.

29. The manual states that Mercury will cancel an insured's coverage if the producer does not provide Mercury with vehicle inspection photos or an automobile inspection form. CIC Sections 401 and 402 44

Management has agreed to suspend the insured's physical damage coverage if it does not receive the automobile inspection form and photos.

30. Mercury is reducing the driving experience period for new insureds whose licenses have been suspended for more than a year, while allowing full credit for new insureds whose licenses have been suspended for lesser periods of time that, when totaled, add up to more than a year.
CIC Section 1861.05(a)

44

Management will submit an amendment to its filing that will reduce the driving experience period for new and existing insureds whose licenses have been suspended, in total, for more than a year.

31. Mercury is deleting the good driver discount from any new policy if the insured has allowed his driver's license to lapse for more than 6 months within the previous three years.
CIC Section 1861.05(a)

45

Management will submit an amendment to its filing that will delete the good driver discount from any new or existing policy if the insured has allowed his driver's license to lapse for more than 6 months.

32. Mercury has not filed the written rating rules that it has been distributing to its employees via its Underwriting Update newsletters.
CIC Section 1861.05(b)

46

Management will file the rating rules.

33. If Mercury is unable to conduct the standard telephone survey, it may cancel the insured's policy even if his application has been completed in its entirety.
CIC Section 1861.03(c)(1) and CCR Section 2632.19(b)(1)

46

This finding is unresolved and will be referred to the CDI Legal Division for review.

34. The telephone survey includes a rate-based question that is ambiguous. 47
CCR Section 2632.5(c)(1)(B) and CCR Section 2632.5(c) and (d)

This finding is unresolved and will be referred to the CDI Legal Division for review.

35. Mercury's advance notice requirements letter does not conform with CCR Section 2632.19(b)(1). 48
CCR Section 2632.19(b)(1) and CIC Section 1861.03(c)(1)

Management will amend its advance notice requirements letter to conform with CCR Section 2632.19(b)(1).

36. Mercury is listing unlicensed, non-drivers on the driver exclusion form if at least one other person included on the form is licensed. If the policyholder refuses to sign the form because he does not want to exclude the non-drivers from coverage, Mercury will cancel his policy. 51
CIC Section 1861.03(c)(1)

This finding is unresolved and will be referred to the CDI Legal Division for review.

37. Mercury has not adopted a procedure for removing c-codes after insureds have regained their eligibility. 53
CIC Sections 790.06 and 1861.05(a)

This finding is unresolved and will be referred to the CDI Legal Division for review.

38. Mercury has not adopted a procedure by which to regulate the c-coding of monoline personal automobile policies. In the absence of such a procedure, Mercury can not ensure that the c-code is applied consistently and equitably among similar risks. 53
CIC Sections 790.06 and 1861.05(a)

This finding is unresolved and will be referred to the CDI Legal Division for review.

39. The premiums quoted to 24 (48%) of fifty new personal automobile policyholders were adjusted upward by Mercury. The high percentage of premium uprates is inconsistent with CIC Section 1861.05(a). 12, 54

This finding is unresolved and will be referred to the CDI Legal Division for review.

40. Mercury charges for accidents recorded on MVRs without first ascertaining whether the insureds were principally at-fault for the accidents. 55
CCR Sections 2632.5(c)(1)(B) and 2632.13(a)

This finding is unresolved and will be referred to the Legal Division.

41. Mercury is unilaterally reforming the policy cancellation clause by refusing to honor backdated cancellation requests. 56
CIC Sections 790.06 and 1861.05(a)

Management agreed to honor the terms of the cancellation clause.

42. Mercury's persistency, anti-theft, and California Medical Association premium credits are not mentioned in its discount notice. 58
CIC Sections 1861.05(a) and 11580.15

Management will add a description of the persistency, anti-theft, and California Medical Association to its discount notice.

43. One personal automobile insurance underwriting computer screen includes a space for recording the insured's national origin. 58
CCR Section 2632.19 and CIC Sections 1861.03(c)(1), 1861.05(a), and 11628(a)

Management will block out the national origin information on the computer screen.

44. MCC has not been offering to write monoline personal automobile coverage for insureds when it terminates their personal package policies for non-CIC Section 1861.03(c)(1) reasons.
CIC Sections 1861.02(b)(1) and 1861.03(c)(1)

58

This finding is unresolved and will be referred to the CDI Legal Division for review.

45. Eleven (21.6%) of the 51 declined application files that were reviewed lacked driver exclusion offer documentation.
CIC Section 1861.02(b)(1) and CCR Section 2632.12(b)

60

This finding is unresolved and will be referred to the CDI Legal Division for review.

46. The underwriters' cancellation/non-renewal reasons were omitted from some of the terminated policy files that were reviewed. Likewise, the underwriters' declination reasons were missing from some of the declination files.
CIC Section 1857

61

Management will instruct the underwriters to document their termination/declination reasons in the files.

48. Certain underwriting instructions that appear on the underwriters' memos to the producers are unfairly discriminatory insofar as they set pre-conditions that are more restrictive than the CIC Section 1861.03(c)(1) "all comers" provision and/or preclude the possibility of the individual's re-applying for a non-good driver policy when he becomes eligible to do so.
CIC Sections 1861.02(b)(1) and 1861.05(a) and CCR Section 2632.2

64

This finding is unresolved and will be referred to the CDI Legal Division for review.

49. Mercury has not added the CCR Section 2632.19 "Substantial Increase in Hazard" based non-renewal criteria to its underwriting manual. 65
CIC Sections 790.06, 1861.03(c)(1), and 1861.05(a)

Management will add CCR Section 2632.19 to the underwriting manual.

50. Mercury has exempted three-pay policies from its short-rate premium refund rule. 66
CIC Section 1861.05(a)

Management will discontinue exempting three-pay policies from its short-rate premium refund rule.

51. Mercury mails notices of cancellation for non-payment of premium 11 days prior to the cancellation effective date. The 11-day elapse time is insufficient to ensure that policyholders are given the full 10-day advance notice of cancellation required by CIC Section 662. 66

This finding is unresolved and will be referred to the CDI Legal Division for review.

California Automobile Assigned Risk Program

52. Two (8%) of the 25 in-force assigned risk automobile policy files reviewed contained non-rating errors. 14, 70
The high error ratio violates CIC Section 1861.05(a). Management has implemented procedures to prevent the reoccurrence of the errors that were cited.

Commercial Automobile Program

53. High error ratios were disclosed by the commercial automobile policy file review. 14, 80
CIC Section 1861.05(a)

Management has implemented measures to remedy the high error ratios.

54. MCC was found using an unfiled schedule rating plan. In addition, the schedule rating plan adopted by the company was improperly applied by utilizing "loss experience", which is an objective rating parameter. The rating plan fails to reflect ranges of credit/debit, indicative of schedule rating. Only fixed factors were being applied. Nine of the errors found involved incorrect credits applied and the lack of schedule rating consideration. CIC Sections 1857, 1861.01(c), and 1861.05(a).

73

Management has filed an objective rating plan to replace the current schedule rating plan.

56. In regards to eligibility and rating, the Fleet Rating Plan fails to define "good loss experience for past 3 years", "Radius if over 50", and MVR qualifications for determining policy type and assignment of drivers. CIC Section 1861.05(a)

76

This finding is unresolved and will be referred to the CDI Legal Division for review.

57. MCC has adopted the practice of c-coding policies that become ineligible for coverage. It is company procedure to non-renew c-coded policies; however, not all policies were set for non-renewal. Consequently, the review revealed policies in which c-coding was waived, while in other instances, policies were not c-coded for failing to obtain required underwriting information. CIC Section 1861.05(a)

78

Management responded by stating that the company will consistently c-code all risks set to non-renew.

58. One policy was canceled on the basis of driving record; however, the risk still qualified for the highest rated tier, Policy Type 4. CIC Section 1861.05(a)

81

This finding is unresolved and will be referred to the CDI Legal Division for review.

Commercial Multiple Peril Programs

59. High error ratios were disclosed by the commercial multiple peril policy file review. 14, 94
CIC Section 1861.05(a)

Management has implemented measures to remedy the high error ratios.

60. Management indicated that MCC would accommodate a risk by providing specialized coverage and a corresponding rate developed by underwriting in order to retain an account. 87
CIC Section 1861.05(a)

MCC has filed for a general rate for any optional property or liability coverages not separately listed under the optional coverages section.

61. The policy review revealed inconsistency in the application of deductibles for various coverage options. In addition, it is company practice to accommodate an agent's request for a certain deductible without a change in premium. 88
CIC Section 1861.01(c) and 1861.05(a)

MCC has expanded the deductible sections in the underwriting manual and filed them with the CDI.

62. MCC failed to adopt a replacement cost methodology for a majority of their commercial multiple peril programs. 88
CIC Section 1861.05(a)

MCC is formally adopting the Marshall & Swift Methodology and is updating data on CD-ROM to be effective September 1, 1998.

63. MCC failed to provide a California Residential Property Insurance Disclosure Statement on those risks that reflect one to four units in the Apartments Program. 92
CIC Section 10101

The company will reproduce the form used for personal lines dwelling fire and conform it for three and four unit family apartment houses.

65. The underwriting guidelines impose a 1975 age restriction for year built with certain programs. The review revealed six policies in which MCC failed to comply with the company-established guideline surrounding age restriction.
CIC Section 1861:05(a)

94

MCC has broadened the underwriting restriction to accommodate buildings built 1960 or later.

66. MCC did not state the specific reason(s) for cancellation on risks that were canceled for failing to meet eligibility requirements.
CIC Section 677.2(b)

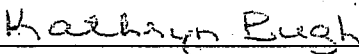
95

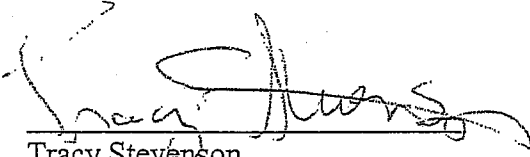
Management will include a brief reason of cancellation on all future cancellation notices.


CERTIFICATION

The foregoing is, to the best of the analysts' knowledge, an accurate representation of the Mercury Insurance Group's business and the facts of the examination. The rate analysts wish to thank the officers and employees of the Mercury Insurance Group for all assistance given during the course of the examination.

Respectfully submitted,


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Associate Insurance Rate Analyst


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Mercury Insurance Group 1998 Exam Report

ADDENDUM

Submitted by: Kathryn Bugh, AIRA

Date: October 20, 2000

The CDI engaged in extensive discussions with Mercury on August 4, 1999 and January 27, 2000 concerning the criticisms that are identified in the 1998 California Rating and Underwriting Examination report as being unresolved. This addendum briefly summarizes each of these criticisms and records the corresponding agreement that was reached, or in the case of an unresolved criticism, the point where the discussions left off. The CDI will follow up with Mercury on the unresolved criticisms.

During the next California Rating and Underwriting Examination, the CDI will verify that Mercury implemented the resolutions that are described in this addendum and the 1998 examination report.

Producer Contracts – Pages 4 and 11 of the Examination Report

The examination report states that approximately 12% of Mercury's producer force have agency appointments and that the remaining producers have broker contracts. The agents and brokers have binding authority, use Mercury applications, and follow Mercury application procedures. At the time of the 1998 examination, Mercury was representing its producer force as "local independent Mercury agents" in its advertisements. Based on these and other considerations, the examination team determined that the brokers were operating as de facto agents.

A few days prior to the January 27, 2000 meeting, the CDI delivered a draft Notice of Noncompliance to Mercury concerning the broker fees charged by the producers who are operating as de facto agents.

During the January 27 meeting, Mercury agreed to the following:

- 1) Mercury will write a response to the draft Notice of Noncompliance. The CDI will notify Mercury if the CDI determines that, after receiving Mercury's response, other action needs to be taken.
- 2) Mercury's producers will represent themselves as Mercury's agents only if they are appointed with Mercury, and Mercury's employees will represent the producers as agents only if the producers are appointed with Mercury.

During the January 27 meeting, Mercury stated that Mercury has been representing its producer force as "agents and brokers" in its advertisements since the 1998 examination.

As of October 20, 2000, the CDI had not received a written response from Mercury to the draft Notice of Noncompliance. The CDI contacted Mercury on October 20 to learn the status of Mercury's written response and was advised that Mercury thought that its obligation to send a written response had been fulfilled by the passage of Assembly Bill 2639, which Mercury supported. Mercury believes that the enactment of Assembly Bill 2639 will resolve the examination criticism and the draft Notice of Noncompliance.

Mercury will contact the CDI's Legal Division to discuss the matter further.

C-Coding Practices – Item 6(a) and (b) on Page 21 and Item 4(a) and (b) on Pages 53 and 54 of the Examination Report

The 1998 examination report states that Mercury applies a "c-code" to the policies of insureds when it determines that they have become ineligible for coverage. Once a policy has been c-coded, Mercury will not make any changes to the policy that would increase its exposure. Consequently, an insured whose policy has been c-coded can not purchase increased limits or additional coverage for his policy, et cetera.

The examination showed that, contrary to CIC Section 1861.05(a), Mercury had not adopted a procedure by which to regulate the c-coding of policies and that Mercury had no mechanism in place for removing c-codes from the policies of insureds who had regained their eligibility.

The following was agreed upon at the January 27 meeting:

- 1) Mercury is using its new business ineligibility guideline as its basis for determining whether a policy should be c-coded. If an insured is technically eligible for coverage, but has an unacceptable risk permutation that is not addressed in the ineligibility guideline, Mercury will document its reasons for c-coding the insured's policy.
- 2) For each policy that is c-coded, Mercury will send a communication to the producer stating the reason why the policy is c-coded and instructing the producer to contact Mercury for approval before adding drivers, vehicles, higher limits, coverages, et cetera to the c-coded policy.
- 3) For each c-coded policy that is non-renewed, Mercury will send a communication to the producer stating: "Do not resubmit without Mercury's prior approval unless the applicant is a good driver."
- 4) Mercury observes that its underwriters do not automatically reject any c-coded policyholder's request to add drivers, vehicles, higher limits, coverages, et cetera to his c-coded policy; instead, the underwriters evaluate each such request to determine whether the insured is

eligible to receive the added coverage. Because this procedure is unwritten, Mercury will put the procedure in writing and issue it to the underwriters.

Mercury reported on March 21, 2000 that the changes have been made.

Standard Telephone Survey – Item 7(a) on Page 22 and Item 2(a) on Page 46 of the Examination Report

The examination report states that Mercury attempts to conduct a telephone survey of each insured who has been issued an insurance policy. The insured is notified of the telephone survey at the point of sale, and Mercury makes several attempts to contact the insured for the purpose of conducting the telephone survey. If Mercury is unable to conduct the telephone survey for an insured, Mercury either waives the telephone survey or cancels the insured's policy.

The examination showed that the telephone survey form does not provide Mercury with material underwriting information beyond what is already requested on the application. The question has therefore been raised as to whether Mercury can lawfully cancel a personal automobile insured's policy based on "substantial increase in hazard" if the insured's application is completed in its entirety. A similar question has been raised concerning other lines of business that are not governed by CIC Section 1861.03(c)(1).

The examination also showed that Mercury has no written guidelines by which to waive telephone surveys. Without guidelines, the waiving of telephone surveys is a matter of individual underwriting judgement. This arrangement creates the potential that the telephone survey will not be waived for similarly-situated insureds.

During the January 27 meeting, Mercury stated that the telephone survey is a useful mechanism for identifying inaccuracies in the information reported on the insured's application. Mercury also stated that it does not cancel the personal automobile policies of statutory good drivers who have not participated in the telephone survey.

The following was agreed upon at the meeting:

- 1) Mercury will send the CDI Legal Division a legal opinion concerning the cancellation of a non-good driver's personal auto policy due to his nonparticipation in the telephone survey when his application has been completed in its entirety. Mercury will also provide the CDI Legal Division with other information in support of its use of the telephone survey.
- 2) Mercury reports that only a small percentage of risks (about 1%) are ultimately canceled due to an insured's nonparticipation in the telephone survey. Mercury's management reviews the policy files of insureds whose policies are due to be cancelled due to their nonparticipation in the telephone survey. If management decides to waive a cancellation, management documents the reason for the decision.

Mercury sent a copy of the legal opinion to the CDI Legal Division on February 1, 2000. The legal opinion is under review.

Notice of Non-Coverage of Earthquake – Item 8(B) of Page 24 of the Examination Report

The examination report states that Mercury does not issue the first Notice of Non-Coverage for Earthquake insurance to the Homeowners insurance policyholder until the policyholder has rejected Mercury's first and second Earthquake insurance offer. By not issuing a Notice of Non-Coverage after the policyholder's rejection of the first Earthquake insurance offer, but before the policyholder's rejection of the second Earthquake insurance offer, Mercury is violating CIC Section 10086.1.

At the January 27 meeting, Mercury agreed to provide Homeowners insurance policyholders with the Notice of Non-Coverage at the time of the initial policy issuance. After that, Mercury will provide Homeowners insurance policyholders with the Notice of Non-Coverage on an every-other-year basis.

Mercury's producers provide the Earthquake insurance offer to Homeowners insurance applicants when the producers take their applications.

Mercury has implemented the agreement.

Ambiguous Homeowners, Personal Umbrella, and Personal Automobile Underwriting Eligibility Criteria – Item 1 of Page 28, Item 1(D) of Page 37, and Item 10 of Page 76 of the Examination Report

The examination report identified certain Homeowners, Personal Umbrella, and Personal Automobile underwriting eligibility criteria that are vague and ambiguous. The use of indefinite eligibility criteria can result in unfair discrimination.

Following the August 4, 1999 meeting, Mercury agreed to publish eligibility criteria that are more definitive. Mercury also stated that it had filed a new rate plan effective March 1, 1999 that should resolve item 10 of page 77 of the examination report.

Personal Umbrella Unacceptable Occupation Criteria – Item 1 of Page 25 of the Examination Report

The examination report notes that Mercury's Umbrella occupation eligibility rule includes a list of 26 occupations that are labeled "U" for unacceptable. Because the "U" designations are discriminatory, the CDI requested that Mercury provide the CDI with actuarial justification for each "U" labeled occupation. Mercury did not provide the actuarial justification.

During the January 27 meeting, the CDI stated that the CDI's Legal Division will review Mercury's "U" labeled occupations and decide what it will do. The CDI encouraged Mercury to provide support for its use of the Umbrella Program's unacceptable occupation criteria.

In reply, Mercury provided the following statement:

"As you know, the personal umbrella policy provides, at least, excess liability coverage over the personal liability coverage of the homeowner policy and the liability coverage of the automobile policy. Many of the occupations are occupations that, in our judgement, pose automobile liability exposure above average. Some are obvious, some less so. Messengers and auto repossessioners are obvious, others are based on our experience. Some present above average exposure under the non auto liability coverage – Example: An artisan Jewelry Salesperson can sometimes carry hundreds of thousands of dollars in samples and handguns. Private detectives present above average auto liability exposure and are more subject to lawsuits for slander, libel and libel and defamation of character (covered under the 'personal injury' coverage of the homeowner policy). Please see page 754.2 California Department of Insurance Bulletin 80-11 clearly recognizing the use of judgement in underwriting (unless specifically prohibited by statute)."

This issue is unresolved.

Personal Umbrella Occupation-Related Application Submission Requirement – Item 2 of Page 25 of the Examination Report

The examination report notes that Mercury's Umbrella occupation eligibility rule includes a list of six occupations that are labeled "S" for "submit non-bound." Some of the criteria that Mercury uses to evaluate these applications are unwritten, a violation of CCR Section 2360.2.

By targeting these occupations for special review, Mercury is failing to apply its underwriting criteria uniformly across all occupations. This being the case, Mercury is discriminating unfairly against "S" labeled occupations.

The list of "S" labeled occupations is as follows:

- Artists
- Emergency vehicle drivers
- Automobile claims adjusters employed by other insurers
- People who are self-employed and working out of their homes
- People who are unemployed
- People who work out of their homes and have one source of income

Following the August 4, 1999 meeting, Mercury issued a November 8, 1999 memo stating the following:

“...we propose to amend the Guidelines for non-bindable occupations – Umbrella Coverage as follows:

1. Artists – Decline well known individuals, home galleries, and creations involving hazardous materials.
2. Self-Employed and working from home – Decline businesses with employees other than family members, medical occupations, risks without underlying business liability coverage, or business involving regular visits by vendors/clients.
3. Unemployed – Decline if the prior occupation was unacceptable.

Note: We have deleted emergency vehicle drivers and automobile claims adjusters from this category.”

Personal Automobile Occupation-Related Submission Requirement – Item 1(A) of Page 33 and Item 1(B) of Page 35 of the Examination Report

Mercury’s underwriting manual states that if an applicant is employed as an artist, an emergency vehicle operator, an insurance automobile or personal injury liability claims adjuster, or as an entertainer, then the producer is to submit his application as non-bound. The examination report states that Mercury is violating CIC Section 11628(c) by targeting applicants employed in these occupations for special review.

The examination report also notes that Mercury’s underwriting manual requires that producers submit the applications of non-good drivers employed in the military as non-bound, also. Contrary to CIC Section 11628(c), no exemption is included in the manual for military personnel who are on active duty service in the United States Armed Forces.

Following the August 4, 1999 meeting, Mercury issued a September 3, 1999 memo in which Mercury stated: “Artists, Emergency Vehicle Operators, Insurance, Military, and Students will be deleted from the ‘occupations’ list.” In its fax of September 27, 1999, Mercury confirmed that entertainers will be deleted from the occupations list, also.

Personal Non-Owned Automobile Coverage “Stripper” Endorsement – Item I(C) of Page 36 of the Examination Report

The examination report notes that Mercury’s underwriting manual requires that the non-owned automobile coverage be deleted, or “stripped” from the policies of good drivers who are employed in certain prescribed occupations. By limiting the good driver’s coverage to the

vehicles listed on his policy, Mercury is denying him the full use of the non-owned, personal use automobile coverage that is provided in the standard coverage form. In so doing, Mercury is failing to comply with CCR Section 2632.14.

Following the August 4, 1999 meeting, Mercury agreed to eliminate the use of the "Stripper" endorsement.

Personal Automobile "Student" Ineligibility Rule – Item 1(E) of Page 38 of the Examination Report

The examination report notes that Mercury's underwriting manual states that students with less than 10 years' residency in the United States are ineligible for coverage. This ineligibility rule is incompatible with CIC Section 11628(a) because it discriminates against students who originate from countries outside the United States.

Following the August 4, 1999 meeting, Mercury agreed to eliminate the residency requirement for students.

Personal Automobile Underwriting Procedure for Drivers with Medical Conditions – Item 1(F) of Page 39 of the Examination Report

The examination report notes that Mercury does not require its underwriters to write personal automobile coverage for applicants who are diabetic, cardiovascular patients, or who suffer from some other medical condition if they qualify for the coverage, are licensed to drive, and have a satisfactory medical report. The absence of this requirement has resulted in violations of CCR Section 2360.2 and CIC Section 1861.05(a).

Following the August 4, 1999 meeting, Mercury agreed to "accept applicants with medical conditions if they qualify for the coverage, are licensed to drive, and have a satisfactory medical report."

Ambiguous Personal Automobile Liability Limit Eligibility Criteria – Item 1(G) of Page 41 of the Examination Report

The examination report states that Mercury "may decline" to write liability limits greater than \$15,000/\$30,000/\$10,000 for "some" non-good driver risks that satisfy two or more of the rule's criteria. The rule's ambiguity creates the potential for unfairly discriminatory underwriting decisions.

Following the August 4, 1999 meeting, Mercury stated that it will "amend the rule to read 'will decline' for 'all' non-good drivers."

Good Driver 18-Month U.S. or Canada Licensing Requirement – Item 1(H) of Page 41 of the Examination Report

Mercury's personal automobile rating and underwriting manual states that in order for an insured to qualify as a good driver, he "must have been continuously licensed to drive a motor vehicle for the preceding three years with a valid U.S. or Canadian license for all of the last 18 months."

The 1998 examination report states that the 18-month requirement is inconsistent with CIC Section 1861.025(d) and CCR Section 2632.13(i).

During the January 27 meeting, the CDI interpreted CIC Section 1861.025(d) as stating that if an insured has not been licensed to drive in the U.S. or Canada for the preceding 18 months, he can still prove his eligibility for the good driver discount by providing "credible" evidence that he has met the good driver discount eligibility requirements for the preceding three years. Along these lines, the CDI also stated that Mercury needs to develop guidelines by which to determine the credibility of the evidence provided by insureds. The CDI acknowledged that some countries maintain better driving records of their licensees than do other countries.

The CDI observed that the legal interpretation of the statute was not conceded by Mercury and that the practical application of the statute raises difficulties. Mercury agreed to obtain a legal opinion on the statute to give to the CDI Legal Division to review. The CDI suggested that there may be a possibility of the CDI's looking into the development of a policy decision concerning this statute.

On March 21, 2000, Mercury provided the following statement:

"Our legislative advocate is still trying to locate the legislative file on this issue. We originally thought Senator Johnston authored the legislation. Now it appears it was Senator Lancaster, who departed the legislature many years ago. Pending resolution of this issue, we are willing to adopt Mr. McClaran's recommendation that we allow the Good Driver Discount if the insureds provide us with verifiable, credible driving history issued by the appropriate governmental authority that supports their qualification, along with other information available to us, for a Good Driver Discount."

CLUE-Related Automobile Accident Surcharge Procedure – Item 1(L) of Page 43 of the Examination Report

The examination report notes that Mercury automatically charges for any accident recorded on a CLUE report for which a claims reserve has been opened unless the CLUE report shows that the insured is not at fault, or that the reserve has been closed without payment. The examination report further notes that Mercury is prohibited by CCR Sections 2632.5(c)(1)(B) and 2632.13(a) from automatically charging for an accident recorded on the CLUE report when Mercury's sole basis for doing so is the fact that a claims reserve has been established for the accident and the insured is not reported as being at-fault.

On March 21, 1999, Mercury agreed to "verify chargeability prior to assessing a point surcharge for CLUE accidents without a chargeability indicator."

Telephone Survey Rate-Based Question – Item 2(B) of Page 47 of the Examination Report

The examination report notes that Mercury's telephone survey includes an automobile accident rate-based question that is sufficiently ambiguous as to create the potential for Mercury to charge for non-fault accidents in violation of subpart (c)(1)(B) of CCR Section 2632.5 and subparts (a), (d), (f), and (g) of CCR Section 2632.13.

On September 27, 1999, Mercury stated the following:

"Under item #34, page 108 of the examination report, the telephone survey question will be revised as follows:

- A. How many accidents have you or any listed driver been involved in during the past 3 years in which you or they were principally at fault (over 50%)?
- B. Was anyone injured?
- C. Did the total loss or damage exceed \$500?"

Personal Automobile Driver Exclusion Form – Item 3(B) of Page 51 of the Examination Report

The examination report notes that Mercury is listing unlicensed, non-drivers on the driver exclusion form if at least one other person included on the form is licensed. If the policyholder refuses to sign the form because he does not want to exclude the non-drivers from coverage, Mercury will cancel his policy, thereby violating CIC Section 1861.03(c)(1).

On September 3, 1999, Mercury agreed to "list only drivers on the U45A (subject to cancellation if not returned), and only non-drivers on the U45C (not subject to cancellation)."

This agreement complements Mercury's earlier statement that Mercury "will only issue the U-202B letter (the advance notice requirements letter) on the U-45A and specify return of the U-45A."

Personal Automobile Premium Uprates – Page 12 and Item 5(A) of Page 54 of the Examination Report

The examination report notes that the personal automobile premiums quoted to 24 (48%) of fifty new personal automobile policyholders were adjusted upward by Mercury. Thirteen of the uprates (54%) were attributed at least in part to Mercury's removal of premium discounts when the producers failed to submit the required documentation for these discounts with the insureds' applications. Mercury is ultimately responsible under CIC Section 1861.05(a) for ensuring that the premium quotation service that it provides to the public is relatively free of error so that the number of upward premium adjustments is minimized.

On September 3, 1999, Mercury stated the following:

“We have modified our procedures to issue with discounts given by the agent and memo for proof if not submitted with the application.”

Automobile Accident Surcharge Procedure – Item 5(B) of Page 55 of the Examination Report

The examination report notes that Mercury charges for accidents recorded on MVRs without first ascertaining whether the insureds were principally at-fault for the accidents. Mercury is prohibited by CCR Sections 26321.5(c)(1)(B) and 2632.13(a) from charging for an accident if Mercury has not first established under CCR Section 2632.13 that the driver was principally at-fault.

On September 3, 1999, Mercury agreed to “verify chargeability prior to assessing a surcharge.”

Personal Package Policy Termination Procedure – Item 7 of Page 58 of the Examination Report

The examination report notes that Mercury has not been offering to write monoline personal automobile coverage for insureds when it terminates their personal package policies for non-CIC Section 1861.03(c)(1) reasons. Consequently, Mercury has been violating CIC Sections 1861.02(b)(1) and 1861.03(c)(1).

On September 3, 1999, Mercury agreed to “offer to write a monoline Personal Auto Policy for eligible insureds whose package policy is cancelled for non-CIC Section 1861.03(c)(1) reasons.”

Driver Exclusion Offer Documentation – Item 1 of Page 60 of the Examination Report

The examination report notes that four (2.3%) of the 174 terminated policy files and eleven (21.5%) of the 51 declined application files that were reviewed during the examination lacked driver exclusion offer documentation. Mercury is responsible under CIC Section 1861.02(b)(1) and CCR Section 2632.12(b) for offering every good driver the option of signing a Driver Exclusion form to delete the non-good driver from coverage when the non-good driver's ineligibility constitutes the basis for Mercury's cancellation, non-renewal, or declination of coverage.

On September 3, 1999, Mercury stated the following:

“All underwriters are instructed to offer every good driver the option of rewriting a policy if a non-good driver is the basis for a cancellation or non-renewal. We are also pre-printing a statement to that effect on the Declination Memo.”

Underwriting for Acceptability – Item 3 of Page 61, Item 4 of Page 63, and Page 81 of the Examination Report

Mercury was criticized during the 1998 examination for declining applications or terminating policies based on the underwriter's determination as to the acceptability of the risk exposure when the insured is technically eligible for coverage under Mercury's guidelines. The criticism was based on CIC Section 1861.05(a) and CCR Section 2360.2, as interpreted by the CDI in its October 21, 1994 “Initial Statement of Reasons” for the adoption of RH-329.

Extensive discussions have been held on this subject between the CDI and Mercury. During the January 27 meeting, the CDI noted that ineligibility guidelines can be changed from one day to the next and consist of both the written guidelines printed by the company and the underwriter's decisions to accept or decline risks with risk exposures that are not addressed by the written guidelines. The CDI further noted that the underwriter needs to accept applicants who are eligible for coverage under the written guidelines, but if a technically-eligible applicant has a permutation that makes him unacceptable for coverage, or if an insured incurs changes that make him unacceptable for continued coverage, the underwriter can reject or terminate coverage for that risk as permitted under the law, but must document his reasons for doing so.

The CDI noted that Mercury needs to be as consistent as it can be in its decisions to accept or reject risks. If Mercury rejects one applicant for coverage, but accepts three others that are similar to the first, then Mercury needs to be able to show through documentation why the first applicant was unacceptable, but the other three were acceptable.

In summary, the CDI stated that Mercury needs to document the reasons for deviations from the ineligibility guidelines, be as consistent as possible in its rejection/termination of coverage for similar risks, and keep the ineligibility guidelines updated to assist the underwriters.

Along these lines, Mercury agreed to the following:

- 1) Mercury's underwriters will document their reasons for deviating from the adopted ineligibility guidelines when they reject applications or terminate the policies of individuals who are technically eligible for coverage.
- 2) Mercury will work toward keeping its ineligibility guidelines current with underwriting decisions affecting the rejection or acceptance of risks with common characteristics.
- 3) Mercury will establish a basis under CIC Section 1861.03(c)(1) and/or CCR Section 2632.19 when it non-renews or cancels personal automobile policies.

On March 21, 2000, Mercury provided the following statement:

"Underwriters have been instructed to document rejections and terminations. We will continue to update our acceptability criteria on an ongoing basis. It has always been our practice and policy to comply with CIC Section 1861.03(c)(1) and CCR Section 2632.19 when non-renewing or canceling a policy."

Underwriting Instructions to the Producers – Item 5 of Page 64 of the Summary of Major Examination Criticisms of the Exam Report

The examination showed that certain underwriting instructions that appear on the underwriters' personal automobile cancellation-related memos to the producers are unfairly discriminatory insofar as they set pre-conditions that are more restrictive than the CIC Section 1861.02(b)(1) "all comers" provision and/or preclude the possibility of the individual's re-applying for a non-good driver policy when he becomes eligible to do so.

The following was agreed upon during the January 27 meeting:

Mercury agreed that its communication to the producer will state something to the effect of: "Don't bind without underwriting approval unless good driver." This instruction will be pre-printed on the communication to the producer, and the underwriters will be notified not to write directions to the producer that contradict the pre-printed instruction.

On March 21, 2000, Mercury provided the following statement:

"Underwriters have been adding this wording to all appropriate correspondence, and it will be pre-printed April 15, 2000."

**Eleven-Day Advance Notice of Cancellation of Personal Automobile Policies
– Item 9 of Page 67 of the Examination Report**

The examination report notes that Mercury mails notices of cancellation for non-payment of premium 11 days prior to the cancellation effective date.

Since the time of the examination, the CDI has determined that an 11-day advance notice of cancellation of a personal automobile policy does not violate CIC Section 662; accordingly, this item is considered to be resolved.

Imposition of Reduced Limits of Liability for Commercial Automobile Risks –Item 8 of Page 75 of the Examination Report

The examination showed Mercury is deviating from its established Commercial Automobile Program guidelines by imposing reduced limits of liability.

During the January 27 meeting, the following was agreed upon:

- 1) Mercury's underwriters will document their reasons for deviating from the guidelines.
- 2) Mercury will work toward a) identifying re-occurring deviations from the guidelines and b) adding these exceptions as standard criteria to the guidelines.

On March 21, 2000, Mercury provided the following statement:

“Underwriters have begun documenting reasons for requesting limit restrictions, and we will continue to evaluate and update guidelines in this area.”

Offering More Expensive Rating Tier to Commercial Automobile Risks that No Longer Qualify for Rates Offered in the Less Expensive Rating Tier – Page 81 of the Examination Report

The examination showed that a commercial automobile policy had been canceled on the basis of driving record; however, the insured still qualified for the more expensive rating tier, Policy Type 4. Mercury's failure to underwrite the policy in accordance with company-established rules violated CIC Section 1861.05(a).

During the January 27 meeting, Mercury stated that if an insured is no longer eligible for coverage in the Less Expensive Rating Tier, Mercury will underwrite to see if he is eligible for coverage in the More Expensive Rating Tier. But, if the insured's exposure has changed in a way that makes him ineligible for coverage in the More Expensive Rating Tier, Mercury will non-renew his coverage.

The CDI concurred that Mercury needs to underwrite for eligibility in other tiers before determining that an insured should be non-renewed due to a change in his exposure.

On March 21, 2000, Mercury provided the following statement:

“Underwriters will continue to determine eligibility in all tiers prior to declination.”