

REPORT OF EXAMINATION

OF THE

MARKET CONDUCT AFFAIRS

OF

DIRECT GENERAL INSURANCE COMPANY OF LOUISIANA

BATON ROUGE, LOUISIANA

AS OF

December 31, 2006

COMPANY CODE 14630

COMPANY ETS EXAM # LA071-M68

TABLE OF CONTENTS

Table of Contents...	2
Salutation...	3
Foreword...	4
Purpose and Scope of Market Conduct Examination...	4
Company Overview...	5
Company History...	5
Territory and Plan of Operations...	6
Parent, Subsidiaries and Affiliated Companies...	8
Insurance Operations...	8
Producer Operations...	10
Premium Finance Operations...	11
Subsequent Events...	12
Recommendations from Prior Examination Reports...	12
Complaint Review...	12
Producer Review...	13
Marketing and Sales Review...	14
Underwriting and Rating Review...	15
Claims Review...	16
Unclaimed Property...	19
Consumer Privacy Policy ...	19
Conclusion...	20



LOUISIANA DEPARTMENT OF INSURANCE

P.O. Box 94214
BATON ROUGE, LOUISIANA 70804-9214
PHONE (225) 342-5900
FAX (225) 342-3078
<http://www.lidi.state.la.us>

May 18, 2007

Honorable James J. Donelon
Commissioner of Insurance
P O Box 94214
Baton Rouge, Louisiana 70804-9214

Sir:

Pursuant to your instructions and authorization, and in compliance with statutory provisions, a targeted market conduct examination has been made of the affairs of the

Direct General Insurance Company Of Louisiana
10225 Florida Blvd.
Baton Rouge, Louisiana 70815

as of December 31, 2006 and the report of examination is herewith submitted.

FOREWORD

In accordance with *LRS 22:1301, et seq.*, a targeted market conduct examination was conducted on the activities of Direct General Insurance Company of Louisiana from January 1, 2004 through December 31, 2006. The examination was performed by test with all test results set forth in this report.

PURPOSE AND SCOPE OF MARKET CONDUCT EXAMINATION

The market conduct examination of Direct General Insurance Company of Louisiana, hereinafter referred to as ("Company") or ("Direct General") was a targeted market conduct examination authorized by the Louisiana Department of Insurance ("Department"). The examination was targeted, in that not all examination procedures contained in the National Association of Insurance Commissioners ("NAIC") Market Regulation Handbook were performed.

The examination included, but was not limited to, the following areas of the Company's operation:

- Company Overview,
- Complaints,
- Underwriting and Rating,
- Producer Licensing and Appointments,
- Marketing and Sales,
- Claims,
- Unclaimed Property, and
- Consumer Privacy Policy

The purpose of this examination was to review compliance by the Company with Louisiana Insurance Laws, Regulations, Directives and the National Association of Insurance Commissioners ("NAIC") Guidelines. The NAIC Guidelines set the standard

of conduct for a property and casualty insurer and promote a program of fair treatment of policyholders. Portions of the NAIC Market Regulation Handbook 2006 were used as a measure of compliance.

The ACL (Audit Control Language) computer software program, a data manipulation and analysis program provided by the Department, was utilized in this examination. Samplings of the data were utilized to test the Company's records and procedures for statutory compliance. The ACL program was used, when possible, to statistically generate a random sampling of data records. "Random" is a theoretical concept meaning that all items in a population or file, before selection, have an equal chance of appearing in the sampling. In instances in which ACL was not used, a systematic (sequential) sampling of certain Company record listings or a judgmental sampling was selected.

Generally, a random or systematic sampling size of sixty (60) records was selected for review. A minimum confidence level of ninety-five percent (95%) with a maximum error rate of five percent (5%) was also used for all samples except complaint testing, which was judgmentally selected.

COMPANY OVERVIEW

COMPANY HISTORY

The Company was incorporated as MAJ Insurance Company (Louisiana) on October 21, 1983 and commenced business April 3, 1984. The Company's Louisiana Certificate of Authority was suspended in 1987 and reinstated September 23, 1996. The suspension was due to a change in ownership without authorization by the Department. On June 16, 1987, Elevating Boats, Inc. sold the stock of the Company to Don

MacDonald (President of Elevating Boats, Inc.). On October 26, 1987, ownership was transferred to Robert C. Hains in settlement of a court judgment. On July 13, 1995, Robert C. Hains entered into an agreement with Imperial Management Corporation (IMC) giving IMC the right to acquire the stock and charter of the Company. On November 16, 1995, Direct Insurance Company (Tennessee) entered into an agreement with Imperial Management Corporation to purchase IMC's rights to acquire the stock and charter of the Company. The Department approved the acquisition at an August 15, 1996 hearing.

By amendment of the Articles of Incorporation on September 16, 1996, the name of the Company was changed to Direct General Insurance Company of Louisiana (DGIC/LA), and the address of the Company was changed from Braithwaite, Louisiana to Baton Rouge, Louisiana. After many years of inactivity, DGIC/LA resumed business as an active insurer in the 4th quarter of 1996 under the ownership of Direct Insurance Company (DIC).

Direct General Corporation (DGC), the parent company of DIC and all of DGC's direct and indirect subsidiaries, acquired ownership of DGIC/LA on December 31, 2003. Pursuant to a Stock Purchase Agreement by and between DIC and DGC dated as of December 1, 2003, DGC acquired 100% of the issued and outstanding capital stock of DGIC/LA. The Louisiana and Tennessee Departments of Insurance approved the acquisition. DGC now maintains control of DGIC/LA by holding 100% of its outstanding capital voting stock as a long-term investment in an operating subsidiary.

TERRITORY AND PLAN OF OPERATIONS

The Company is licensed in Louisiana to write the following lines of business:

Vehicle	Fire & Extended Coverage
Liability	Marine & Transportation (Inland Marine)
Worker s' Compensation	Miscellaneous
Burglary & Forgery	

Direct General markets non-standard private passenger automobile insurance in Louisiana. Direct General Insurance Agency of Louisiana, Inc., an affiliate, markets the Company's products directly through neighborhood sales offices. Approximately 95% of the policies sold are financed by its affiliated premium finance companies: Direct General Financial Services, Inc. or Direct General Premium Finance Company.

The Company is part of a holding company system whose principal operating subsidiaries provide non-standard private passenger automobile insurance, term life insurance and premium finance and other consumer products and services primarily on a direct basis throughout most of the southeastern United States. Operating subsidiaries include property/casualty insurance companies, life/health insurance companies, premium finance companies, insurance agencies, administrative service companies, and one (1) company providing non-insurance consumer products and services.

The Company's annual statements for the period under examination reflected the following Louisiana written premium:

YEAR PREMIUMS WRITTEN

2004	\$ 31,531,954
2005	25,302,673
2006	25,275,205

PARENT, SUBSIDIARIES AND AFFILIATED COMPANIES

The Company's ultimate parent company is Direct General Corporation ("DGC"), a publicly traded Tennessee business corporation. DGC was incorporated on September 28, 1993 for the purpose of serving as the ultimate parent company for Direct General's Holding Company System. Through its subsidiaries, DGC's core business involved the issuance of non-standard personal automobile insurance policies throughout most of the southeastern United States. These policies, which are generally issued for minimum limits of coverage, provided coverage to drivers who usually cannot obtain insurance from standard carriers due to a variety of reasons. Through its premium finance operations, the premium charges for the majority of the insurance policies sold by the Company were financed.

The organizational chart displayed on the following page identifies the members of Direct General's Holding Company System, along with a brief description of most members.

INSURANCE OPERATIONS

The Direct General Group is comprised of seven (7) insurance subsidiaries. Five (5) are property and casualty insurance companies and two (2) are life insurance companies. Their names and states of domicile are listed:

<u>Subsidiary</u>	<u>State of Domicile</u>
Direct Insurance Company	Tennessee
Direct General Insurance Company	South Carolina*
Direct General Insurance Company of Louisiana	Louisiana

Direct General Insurance Company of Mississippi	Mississippi
Direct National Insurance Company	Arkansas
Direct Life Insurance Company	Georgia
Direct General Life Insurance Company	South Carolina

* Direct General Insurance Company is also commercially domiciled in Florida.

Non-standard personal automobile insurance is the core product for the property and casualty insurers in the Direct General Group. These policies generally are issued for the minimum limits of coverage required by state laws. The life insurance subsidiaries provide basic, one (1) year term policies with limits ranging from \$10,000 to \$25,000 that are guaranteed to be renewable for two (2) additional one-year periods. Underwriting for the term life product generally consists of applicant's answers to certain health related questions.

At December 31, 2006, Direct General Insurance Company of Louisiana and Direct General Life Insurance Company were underwriting policies in the State of Louisiana.

Direct National Insurance Company and Direct Life Insurance' Company are also licensed in Louisiana.

DIRECT INSURANCE COMPANY ("DIC")

DIC was incorporated on November 8, 1990, under the laws of the state of Tennessee, and commenced business as a property and casualty insurer on April 12, 1991. On December 2, 1994, this Company became a direct wholly owned subsidiary of DGC pursuant to a voluntary share-for-share stock exchange.

In August of 1996, DIC acquired MAJ Insurance Company, a then dormant Louisiana domiciled insurer, and later renamed this company to Direct General Insurance Company of Louisiana. Effective December 31, 2003, DGC acquired 100% of the issued and outstanding capital stock of Direct General Insurance Company of Louisiana from Direct Insurance Company pursuant to a stock purchase agreement dated December 1, 2003. This acquisition was approved by the Louisiana and Tennessee Departments of Insurance.

PRODUCER OPERATIONS

Collectively, the insurance companies in the Direct General Group market their insurance products directly to customers through a captive agency distribution system. The Direct General Group has over four hundred fifty (450) neighborhood sales offices throughout the southeastern United States, including Texas. The licensed insurance agencies, wholly owned by Direct General Corporation, that make up this network included the following:

- Direct General Agency of Georgia, Inc.
- Direct General Agency of Kentucky, Inc.
- Direct General Insurance Agency, Inc. – an Arkansas corporation
- Direct General Insurance Agency, Inc. – a Mississippi corporation
- Direct General Insurance Agency, Inc. – a Tennessee corporation
- Direct General Insurance Agency, Inc. – a Texas corporation
- Direct General Insurance Agency of North Carolina, Inc.
- Direct General Insurance Agency of South Carolina, Inc.
- Direct General Insurance Agency of Tennessee, Inc.
- Direct General Insurance Agency of Louisiana, Inc.
- Right Choice Insurance Agency, Inc.*

*Right Choice Insurance Agency, Inc. is licensed as an entity producer in Louisiana.

PREMIUM FINANCE OPERATIONS

Direct General Financial Services, Inc. (“DGFS”)

DGFS, a wholly owned subsidiary of Direct General Corporation, was incorporated under the laws of the state of Tennessee on April 21, 1994. On December 31, 2006, DGFS was licensed as a premium finance company in the states of Florida, Georgia, Kentucky, Louisiana, Mississippi, Missouri, North Carolina, South Carolina, Tennessee, Texas, and was qualified to conduct business in the state of Arkansas. Its principal activities included the financing of premiums for certain insurance companies included within Direct General’s Holding Company System, primarily in the states of Florida and Mississippi.

Direct General Premium Finance Company (“DGPFC”)

DGPFC, a wholly owned subsidiary of Direct General Corporation, was incorporated under the laws of the state of Tennessee on June 11, 2003. On December 31, 2006, DGPFC was licensed as a premium finance company in the states of Georgia, Illinois, Kentucky, Louisiana, Missouri, North Carolina, South Carolina, Tennessee, Texas and Virginia and was qualified to conduct business in the state of Arkansas. DGPFC provides insurance premium finance services for the Company as well as for the other insurance companies in the Direct General Group in all states of operation except Florida and Mississippi.

SUBSEQUENT EVENT

On March 30, 2007, Elara Holdings, Inc. ("Elara"), a privately held Delaware stock corporation which was incorporated on November 21, 2006, acquired 100% of the issued and outstanding stock of Direct General Corporation ("DGC"), a Tennessee corporation which was at the time the Company's parent and the ultimate parent company for the Direct General Corporation Insurance Holding Company System. The indirect change of control of the Company was approved by the Department on March 23, 2007.

RECOMMENDATIONS FROM PRIOR EXAMINATION REPORTS

The Company took corrective action on the previous examination recommendation by providing a denied claim file for this examination.

COMPLAINT REVIEW

This review was conducted in accordance with the provisions of LSA-R.S. 22:1214 (17).

A judgmental sample of ten (10) complaint files from the period under examination was selected for review. Complaints filed against the Company through the Department did not indicate any noticeable pattern or trend. The Company's position on issues resulting in complaints appeared to be reasonable and in accordance with statutes and regulations and policy language.

The Company provided complaint procedures which appeared adequate for the proper recording and timely processing of complaints. For the period under

examination, the Company provided complaint registers which were in compliance with the above Louisiana Statute.

PRODUCER REVIEW

The Company markets auto insurance policies through an affiliate, Direct General Insurance Agency of Louisiana, Inc. ("LaAgency"). LaAgency utilizes salaried producer/employees to perform marketing duties in thirty (30) Louisiana sales offices. These sales offices appear to be well distributed throughout the State of Louisiana.

All sales offices are staffed with a minimum of one (1) licensed producer. All newly hired producers are required to pass the Louisiana producer licensing test and to secure a license within six (6) months from date of hire or be subject to automatic termination.

The Company provided a listing of active producers as of December 31, 2006, which consisted of approximately one hundred and sixty (160) producers. All producers were reviewed in order to verify proper appointments with the Department. This review was performed without exception.

The Company provided a listing of cancelled producer appointments for the period under examination. Most cancelled appointments were the result of job changes; however, one (1) producer appointment was cancelled for fraudulent causes as addressed in **LRS-22:1142**. The review indicated that all producer appointments were cancelled in accordance with **LRS-22:1145 A** or **LRS-22:1145 B** which states as follows:

"1145. Notification to commissioner of termination

A. An insurer or authorized representative of the insurer that terminates the appointment, employment, or contract with a producer for any reason not set forth in R.S. 22:1142, shall notify the commissioner of insurance within thirty days

following the effective date of the termination, in a manner prescribed by the commissioner, stating the circumstances of the termination. Upon written request of the commissioner, the insurer shall provide additional information, documents, records, or other data pertaining to the termination.

B. An insurer or authorized representative of the insurer that terminates the appointment, employment, contract, or other insurance business relationship with a producer shall notify the commissioner of insurance within fifteen days following the effective date of the termination, in a manner prescribed by the commissioner, if the reason for termination is one of the reasons set forth in R.S. 22:1142, or the insurer has knowledge the producer was found by a court, government body, or self-regulatory organization authorized by law to have engaged in any of the activities specified in R.S. 22:1142. Upon the written request of the commissioner, the insurer shall provide additional information, documents, records, or other data pertaining to the termination or activity of the producer.”

The Company advises prospective employees and producers that a consumer report and/or an investigative report including credit reports, criminal records, motor vehicle records, and social security verification may be obtained in processing an application for employment.

The Company’s hiring procedures for producers and employees appear to be in compliance with **Louisiana Bulletin #99-01** dated June 1, 1999 titled “Consent for Prohibited Person to engage in Insurance Business, 18 United States Code, Sections 1033 and 1034.”

MARKETING AND SALES REVIEW

The Company only advertised through the medium of television during the period under examination. Television scripts and yellow page advertisements containing producer phone numbers and small slogans were reviewed without exception.

The Company also provided newsletters which are mailed to the local sales offices. The newsletter primarily contains information on various sales contests.

The Company provided a two (2) week training class for all newly hired producers, along with a training manual which included in-depth marketing and product information.

UNDERWRITING AND RATING REVIEW

The Company provided an electronic file containing all auto policies issued in 2004, 2005, and 2006 to Louisiana residents. ACL was utilized to select a random sampling of sixty (60) new business policies from the three (3) years under examination.

A review of this sampling indicated that applications were properly completed, signed, and dated by the applicant and the writing producer. These applications were issued in accordance with the Company's procedures.

It is the Company's policy to issue policies through its sales offices in approximately one (1) day. Policies not issued due to an error condition are held in a suspense file until the error has been resolved. Once resolved, the policy will be activated on the next policy data cycle.

As an additional test, a sample of fifteen (15) applications was selected from the new business sample to verify that the producers were properly licensed and appointed. No exceptions were detected.

The Company provided a list of its currently used policy forms. This listing was compared to the forms in the sample of new business with no exception.

The Company provided an electronic file of cancelled policies for the period under examination. ACL was utilized to generate a random sampling of sixty (60) cancelled policies for review. Cancellations occur due to the following: underwriting cancellations and insured request. Underwriting cancellations occur because the

Underwriting Department could not resolve such issues as a customer's license had been suspended or vehicle inspection form was not properly completed for comprehensive and collision coverage.

The Company's reasons for cancellation and date of notification to the insured were in accordance with applicable statutes, rules, and regulations.

A judgmental sampling of ten (10) applications was selected from the initial sampling of sixty (60) new business policies in order to verify rating. Rating codes for territory, vehicle usage and symbols, and the insured's classification on the applications were verified against the Company's filed rates with the Department without exception.

CLAIMS REVIEW

The Company provided claims procedures which appeared adequate for the proper processing of its claims. Primarily, claims are received via telephone by the Company's claims processors. The initial telephone call establishes the claim. After the claim is set up on the computer, the claims processor transfers the call to a claims adjuster for further handling. The Company acknowledged that its claim numbers are unique and regardless of branch entry are in sequential order.

The Company provided electronic files containing Louisiana paid claims, claims closed without payment and denied claims for its private passenger automobile insurance. ACL was utilized to extract random samplings from these claim records.

The Company was asked to provide a file of its paid claims only for 2006. After the 2006 paid claims total was reconciled with the Company's annual statement, ACL was utilized to select a random sampling of sixty (60) paid claims. A review of the paid

claims revealed that the claims were paid timely in accordance with policy provision, statutes, and regulations.

A time study of the paid sample indicated that the Company contacted the insured on an average of four and a half (4.5) days from the date the claim was first reported to the Company. A claim payment was made on an average of twenty (20) days from the claim reported date except for claims that resulted in litigation or poor cooperation from the insured, which were excluded from the study.

ACL was utilized to select a random sampling of sixty (60) denied claims for review. A review of these claims revealed these claims were denied in accordance with policy provisions, statutes, and regulations.

The following is a summary of the reasons for denial of the sixty (60) denied claims.

16	Claimant at fault
21	Policy lapse no coverage
01	No pay, No play
04	Due to lack of interest or cooperation of insured
12	No coverage for peril
<u>06</u>	Excluded driver from insured's policy
<u>60</u>	

The denied claims in the above mentioned sample were examined noting no unusual or improper claims handling and the claims practices utilized appeared adequate and in compliance with policy provisions, state statutes and regulations.

ACL was utilized to select a random sampling of sixty (60) claims closed without payment for review. The following is a summary of the reasons or basis for closure of the claim without payment:

- 03 Claim Loss Less Than Deductible
- 10 Reserve coverage for a peril was closed
- 13 Claim closed due to lack of interest of insured
- 14 Peril Not Covered Under Policy
- 15 Company's insured not at fault
- 60

The claims closed without payment in the above mentioned sample were examined noting no unusual or improper claims handling and the claims practices utilized appeared adequate and in compliance with policy provisions, state statutes, and regulations.

The Company's claim files were well documented. The date the claim was received by the claims processor was the same received date reflected in the claim files reviewed by the examiner. The claims adjusters' diaries indicated that claims were vigorously pursued by the adjusters in determining if there was a valid claim for adjudication.

The Company has written a Special Investigative Unit ("SIU") Manual that will be utilized as a guideline by both the Claims Department and the SIU for handling suspicious claims, other suspicious activities, and referral of cases for investigation to the appropriate entity.

UNCLAIMED PROPERTY

This review was performed by the financial examiners and will be addressed in the current financial examination report.

CONSUMER PRIVACY POLICY

Direct General has privacy and confidentiality procedures to secure information regarding policyholders and claimants which were in compliance with the Louisiana Department of Insurance **Regulation 76 / *PRIVACY OF CONSUMER FINANCIAL INFORMATION.***

The majority of Privacy Notices are hand delivered when the applicant signs his or her premium finance agreement. The remainder of Direct General's customers receive their Privacy Notices as a mailing along with their policy of insurance and other related documents.

CONCLUSION

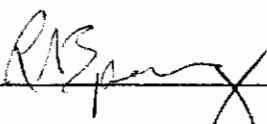
I, Richard A. Spong, do solemnly swear and affirm that I am an Examiner for the Commissioner of Insurance of the State of Louisiana and that as such, I was assigned to conduct a targeted examination of the market conduct activities of

**DIRECT GENERAL INSURANCE COMPANY OF LOUISIANA
BATON ROUGE, LOUISIANA**

That I made such examination and the above and foregoing is a true and correct copy of my report of such Company and the same is true and correct to the best of my knowledge, information and belief.

I wish to thank the courteous cooperation of the Company's officers and employees during this examination process.

Respectfully submitted,


Richard A. Spong, CFE, CIE

Louisiana Department of Insurance