

REPORT OF EXAMINATION

OF THE

MARKET CONDUCT AFFAIRS

OF

DIRECT GENERAL INSURANCE COMPANY OF LOUISIANA

BATON ROUGE, LOUISIANA

AS OF

December 31, 2003

NAIC CODE 14630

NAIC ETS EXAM # LA071-M28

SUBJECT	PAGE NO.
Salutation...1	
Foreword...2	
Purpose and Scope of Market Conduct Examination...2	
Company Overview...4	
Company History...4	
Territory and Plan of Operations...5	
Parents, Subsidiaries and Affiliated Companies...6	
Insurance Operations...8	
Producer Operations...10	
Recommendations from Previous Reports...11	
Complaint Review...11	
Producer Review...12	
Marketing and Sales Review...14	
Underwriting and Rating Review...14	
Claims Review... 15	
Consumer Privacy Policy Review...17	
Comments and Recommendations...18	
Conclusion...19	



LOUISIANA DEPARTMENT OF INSURANCE

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

OCTOBER 1, 2004

Honorable J. Robert Wooley
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 limited market conduct examination has been made of the affairs of the

DIRECT GENERAL INSURANCE COMPANY OF LOUISIANA
BATON ROUGE, LOUISIANA

as of December 31, 2003 and the report of examination is herewith submitted.

FOREWORD

In accordance with **LSA-R.S. 22:1301 D.**, a market conduct examination was conducted on the activities of Direct General Insurance Company of Louisiana from January 1, 2000 through December 31, 2003. The examination was performed by test and all tests applied are included 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"), was a limited routine market conduct examination authorized by the Louisiana Department of Insurance ("LDOI") or ("Department"). The examination was limited, in that not all examination procedures recommended by the National Association of Insurance Commissioners were performed.

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

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

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 Conduct Examiner's Handbook, Volume I were used as a measure of compliance.

The ACL Program, a data manipulation program, provided by the LDOI was utilized in this examination. Samplings were utilized to test the Company's records and procedures for statutory compliance. The ACL Program was used, when possible, to automatically 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 manual random sampling was performed.

Generally a random or systematic sampling size of sixty (60) records will be selected for review. A minimum confidence level of ninety-five percent (95%) with a maximum error rate of five percent (5%) will be used for most samples. Based on a review of the sampling's error rate, additional samplings may be required.

COMPANY OVERVIEW

COMPANY HISTORY

The Company was incorporated as MAJ Insurance Company (Louisiana) on October 21, 1983 and commenced business on April 3, 1984.

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"), which gave 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 Louisiana Department of Insurance 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 and the address of the Company was changed from Brathwaite, Louisiana to Baton Rouge, Louisiana. After many years of inactivity, the Company resumed business as an active insurer in the fourth quarter of 1996.

Effective December 31, 2003, Direct Insurance Company sold 100% of its common stock investment in the Company to its parent, Direct General Corporation ("DGC"), which is a publicly owned financial services holding company.

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 Insurance Company of Louisiana 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 ninety-five percent (95%) of the policies sold are financed by an affiliated premium finance company, Direct General Financial Services, Inc.

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*

2001	\$18,010,754
2002	23,126,638
2003	30,072,711

*Schedule T of the Annual Statements

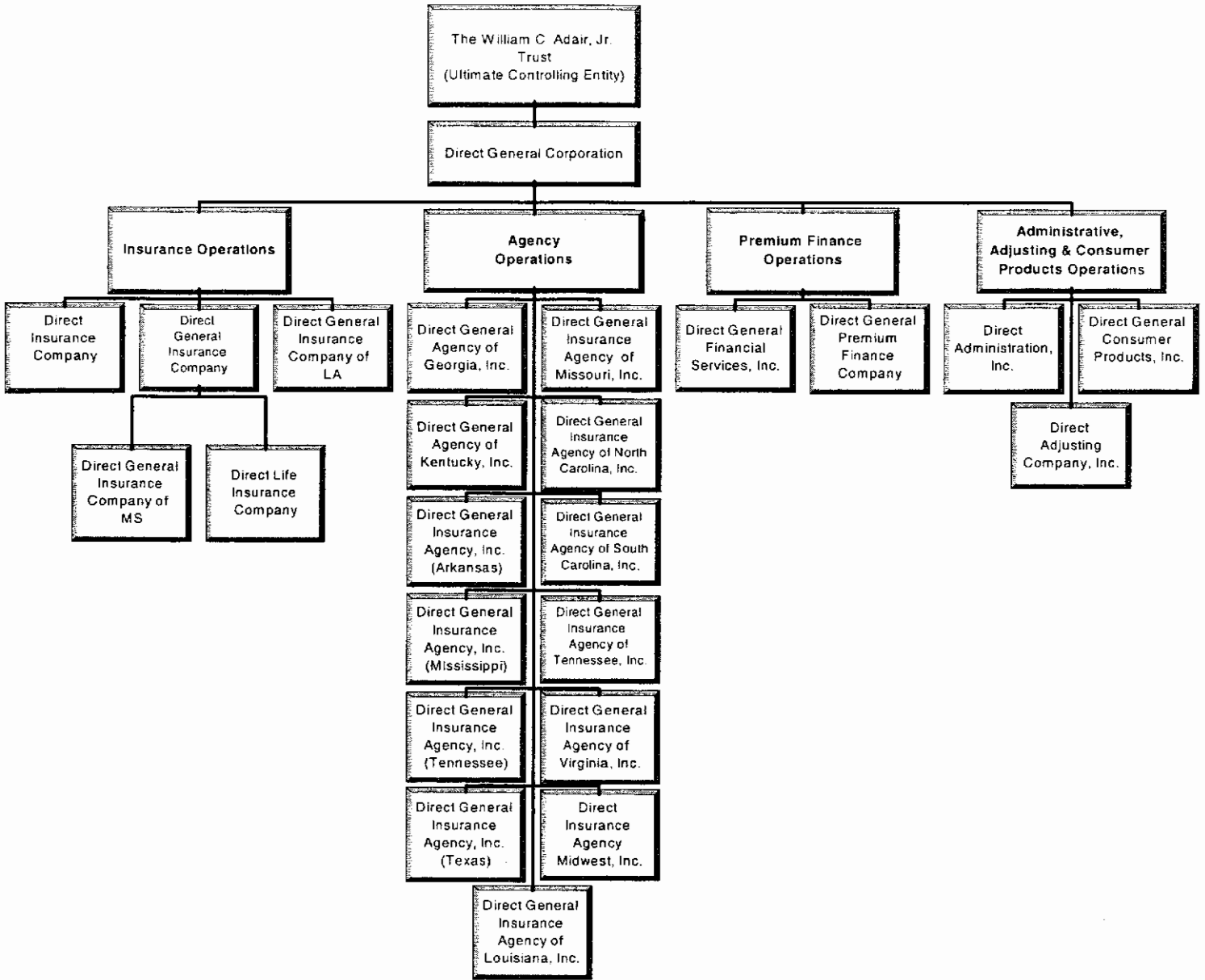
PARENT, SUBSIDIARIES AND AFFILIATED COMPANIES

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 nonstandard 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.

On August 15, 2003, DGC completed an initial public offering (IPO) of its common stock. The shares of common stock sold in the offering were registered under the Securities Act of 1933, as amended, and was declared "effective" by the Securities and Exchange Commission on August 11, 2003.

The Mr. William C. Adair, Jr. Trust is currently the only person or entity owning 10% or more of any class of voting security of DGC. Following the IPO, Ms. Tammy R. Adair, as Trustee of the Mr. William C. Adair, Jr. Trust, controlled approximately 32% of DGC's outstanding common stock.

The following organizational chart displays the identities of the members of Direct General's Holding Company System, along with a brief description of most members.



INSURANCE OPERATIONS

DIRECT INSURANCE COMPANY

This Company 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 wholly owned subsidiary of DGC pursuant to a voluntary share-for-share stock exchange. In addition, DIC is authorized to write one (1) or more lines of property and casualty business in the states of Tennessee and Arkansas.

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 one hundred percent (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.

DIRECT GENERAL INSURANCE COMPANY

This Company was incorporated under the laws of the state of Florida on December 15, 1990 as Independent Property and Casualty Insurance Company ("IPC"), and began operations on January 1, 1991.

Effective March 6, 1997, in contemplation of the company being sold to Direct General Corporation, IPC re-domesticated to the state of Tennessee. On March 14, 1997, Direct General Corporation acquired all of the outstanding capital stock of IPC and its name was changed to its present title. As of December 31, 2003, DGIC was authorized to

write one or more lines of property and casualty business in the states of Alabama, Florida, Georgia, Mississippi, Tennessee and South Carolina.

DIRECT GENERAL INSURANCE COMPANY OF MISSISSIPPI

The Company, wholly owned by Direct General Insurance Company, was incorporated under the laws of the state of Mississippi on October 10, 1997 as Direct General Insurance Company of Mississippi. The Company commenced business on May 7, 1998 with its principal office located in Nashville, Tennessee.

The Company is licensed in the State of Mississippi to transact business referred to as Fire/Allied, Auto Damage/Liability, Casualty/Liability and Home/Farm-owners. On June 26, 2002, the Company became licensed in the State of Kentucky to transact the business of property and casualty; limited to vehicle, liability and glass.

DIRECT LIFE INSURANCE COMPANY

This Company, domiciled in the state of Georgia, was formerly known as Independent Life Insurance Company. In 1998, American General Life and Accident Insurance Company sold this company to DGC, at which time its present title was adopted.

On June 30, 2001, after receiving approvals from the Georgia and South Carolina Departments of Insurance, DGC contributed 100% of the outstanding capital stock of DLIC to Direct General Insurance Company, a wholly owned subsidiary of DGC.

As of December 31, 2003, DLIC was licensed to conduct business in the states of Alabama, Arizona, Arkansas, Colorado, Florida, Georgia, Kentucky, Louisiana, Mississippi, Missouri, New Mexico, South Carolina, Tennessee and Texas.

PRODUCER OPERATIONS

Collectively, the previously described property and casualty insurance companies and life insurance company marketed nonstandard automobile coverage and term life insurance coverage directly to customers through a captive agency distribution conducted through more than three hundred eighteen (318) neighborhood sales offices located in the southeastern United States. The agencies, wholly owned by Direct General Corporation, that were involved within this network included the following:

Direct General Agency of Georgia, Inc.
Direct General Agency of Kentucky, Inc.
Direct General Insurance Agency, Inc. – Arkansas
Direct General Insurance Agency, Inc. – Mississippi
Direct General Insurance Agency, Inc. – Tennessee
Direct General Insurance Agency, Inc. – Texas
Direct General Insurance Agency of Missouri, Inc.
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 Virginia, Inc.
Direct General Insurance Agency of Louisiana, Inc.

PREMIUM FINANCE OPERATIONS

Direct General Financial Services, Inc.

This Company, wholly owned by Direct General Corporation, was incorporated under the laws of the state of Tennessee on April 21, 1994. As of December 31, 2003, 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 the Company, as well as for the other insurance companies included within Direct General's Holding Company System.

Direct General Premium Finance Company

This Company, wholly owned by Direct General Corporation, was incorporated under the laws of the state of Tennessee and was inactive as of December 31, 2003.

RECOMMENDATIONS FROM PRIOR EXAMINATION REPORTS

There were no market conduct issues from the previous Louisiana Financial Examination Report as of December 31, 2001 that required any follow-up during this examination.

COMPLAINTS REVIEW

This review was conducted in accordance with the provisions of **LSA-R.S. 22:1214** "Methods, acts, and practices which are defined herein as unfair or deceptive." Specifically **22:1214 (17)** states as follows:

"Failure to maintain adequate complaint handling procedures. Failure of any insurer to maintain a complete record of all the complaints that it received since the date of its last examination. This record shall indicate the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of each complaint, and the time it took to process each complaint. For purposes of this Paragraph, "complaint" shall mean any written communication primarily expressing a grievance received by the insurer from the Department of Insurance."

The Company provided complaint procedures which appeared adequate for the proper recording and timely processing of complaints. During the examination, the

Company provided complaint registers for the three (3)-year period, which were in compliance with the above Louisiana Statute.

The Company was provided a listing of fifteen (15) complaints that were missing from its complaint registers. The Company was unable to find nine (9) of these complaints, which is in conflict with the above Louisiana Statute.

The Complaint Coordinator for the Company responded that there had been several administrative assistant changes with gaps between employment dates during the examination period. These gaps in employment apparently resulted in errors of omission resulting in the missing complaints.

The Coordinator also indicated corrective action had been taken by adding another level to the Compliance Department; the addition which is a Compliance Specialist/Paralegal will oversee and control the access data base system relating to the complaint activity.

It should be noted that the Company had a small number of complaints for the three (3)-year period under review.

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 twenty-three (23) Louisiana sales offices. These sales offices appear to be well distributed throughout the State of Louisiana and are staffed with approximately seventy (70) producer/employees.

All sales offices are staffed with a minimum of one (1) licensed producer. All newly hired producers are required to pass the Louisiana 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 April 30, 2004, which consisted of approximately one-hundred and thirty (130) producers. All producers were reviewed in order to verify proper appointments. This review was performed without exception.

The Company provided a listing of thirty-three (33) terminated producers for the period under examination. A random sampling of nine (9) terminated producers was selected for review. The review indicated that all appointments were canceled timely in accordance with **LSA-22:1145 B**. The Company stated that no producers were terminated during the period under examination for causes addressed in **LSA-22:1142**.

A judgmental sampling of eleven (11) newly hired producers was selected from the Department's listing of active appointments. This review indicated that once the producer has passed the licensing test and the license has been issued, the Company submitted the appointment to the Department in accordance with **LSA-22:1144 B (1)**.

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. Videos of these television advertisements were reviewed and no violations of statutes or questionable practices were detected.

The Company provides 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 a CD containing all auto policies issued in 2001, 2002 and 2003 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 complete, signed and dated by the applicant and the writing producer. These applications were issued timely.

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.

The Company provided a CD of non-renewed policies for the period under examination. ACL was utilized to generate a random sampling of sixty (60) policies for

review. The Company's reason for non-renewal and date of notification to the insured were in accordance with applicable statutes, rules and regulations.

A random sampling of twenty (20) applications was selected from the initial sampling of sixty (60) new business policies in order to verify rating. Rating codes for territory, automobile usage and classification and insured classification on the applications were verified against the Company's filed rates with the Department without exception.

CLAIMS REVIEW

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

The Company provided CDs containing 2003 paid claims, claims closed without payment and denied claims for its private passenger automobile insurance. ACL was utilized to extract random samplings from these claims records.

After the 2003 paid claims total was reconciled with the annual statement total, 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 showed that paid claims from this sampling were paid in an average of nineteen (19) days.

ACL was utilized to generate the following time study of 2003 paid property damage, collision and comprehensive claims.

RANGE	COUNT	%	DOLLAR AMT	%
0 TO 30 DAYS	5,668	88.22%	\$ 8,256,973	89.98
31 TO 60 DAYS	360	5.60	454,574	4.95
61 TO 91 DAYS	134	2.09	167,150	1.82
91 TO 121 DAYS	73	1.14	87,319	0.95
>121	190	2.95	210,886	2.30
TOTALS	6,425	100.00%	\$ 9,176,902	100.00%

The ACL time study indicated that approximately eighty-eight percent (88%) of the number of claims and ninety percent (90%) of the dollar amount of claims were paid within sixty (60) days from the date the Company received notification of the claim.

ACL was utilized to select a random sampling of sixty (60) claims closed without payment for review. A review of these claims revealed no payments were made primarily for the following reasons: the insured did not provide requested information related to the claim, insured elected not to pursue the claim, the cost of repair was less than the insured's deductible and claimant's insurer was liable for the cost of repair. A review of this sampling indicated these claims were timely processed in accordance with policy provisions, statutes and regulations.

ACL was utilized to select a random sampling of twenty (20) denied claims from the CD of paid claims. After questioning the small population of denied claims, the Company reviewed its records and provided an additional listing of approximately two hundred (200) denied claims. From this listing an additional subjective sampling of twenty (20) denied was selected. These forty (40) denied claims appeared to be denied in accordance with policy provisions, statutes and regulations.

It is recommended that the Company review its procedures for processing of denied claims to assure that *all* denied claims activity will be maintained for easy access for future examinations.

The Company's claim files were well documented. The date the claim was received by the claim processor was the same received date reflected in the paid claim file provided to the examiner.

The Company provided a listing of its open and closed litigated files for the period under examination. A judgmental sample of twenty (20) open and closed files was selected for review. Most litigated claims are primarily the result of bodily injury. Once the Company received requested documentation, such as medical records, the litigated claims were promptly settled in accordance with policy provisions, statutes and regulations.

The individual paid claim files reviewed during this examination did not contain any data on the reserving of the claim. The Company's Claim Operating Guidelines indicate that all reserve amounts are automatically established based on an average of paid claims; such reserving is based on statistical and historical claim data.

Finally, in order to identify and report claim fraud, the Company is a member of the National Insurance Crime Bureau ("NICB") which provides training in casualty fraud detection. In addition, the Company's Special Investigations Unit ("SIU") and supporting training department provide training to all Company claims personnel as to how to identify indicators of fraud and how to refer specific claims to the SIU for verification.

CONSUMER PRIVACY POLICY REVIEW

A review of the Company's Privacy Procedures which govern the privacy of consumer financial information is in compliance with the Louisiana Department of Insurance Regulation 76, *PRIVACY OF CONSUMER FINANCIAL INFORMATION*.

COMMENTS AND RECOMMENDATIONS

It should be noted this was the first routine market conduct examination of the Company. The Company's response time to examination requests during this examination was exceptional.

It is recommended that the Company review its procedures for processing of denied claims to assure that *all* denied claim activity will be maintained for easy access for future examinations.

CONCLUSION

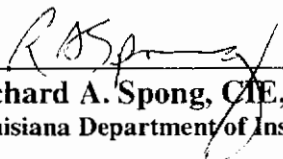
I, Richard A. Spong, do solemnly swear and affirm that I am an examiner for the Commissioner of Insurance of the State of Louisiana and that as such, I was assigned to conduct an examination of the market conduct activities of

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.

The undersigned appreciated the courteous cooperation of the Company's Officers and employees.

Respectfully submitted,


Richard A. Spong, CIE, CFE
Louisiana Department of Insurance