

REPORT OF EXAMINATION
OF THE
MARKET CONDUCT AFFAIRS
OF
NATIONAL AUTOMOTIVE INSURANCE COMPANY
METAIRIE, LOUISIANA
AS OF
DECEMBER 31, 2004

COMPANY CODE 37486

COMPANY ETS EXAM # LA071-M34

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LOUISIANA DEPARTMENT OF INSURANCE
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May 31, 2005

Honorable 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

NATIONAL AUTOMOTIVE INSURANCE COMPANY

111 VETERANS BOULEVARD

SUITE 1420

METAIRIE, LOUISIANA 70005

as of December 31, 2004 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 NATIONAL AUTOMOTIVE INSURANCE COMPANY from January 1, 2002 through December 31, 2004. 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 NATIONAL AUTOMOTIVE INSURANCE COMPANY, hereinafter referred to as ("Company") was a limited routine market conduct examination authorized by the Louisiana Department of Insurance ("LDOP") 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 Louisiana Department of Insurance 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

On February 22, 1988, a Louisiana partnership was formed and named National Automotive Insurance. On July 29, 1988, the partnership was registered with the Louisiana Secretary of State as Lloyd's Plan Insurer.

On April 5, 1990, the Lloyd's Plan Insurer and the Louisiana Department of Insurance entered into an agreement whereby the partners infused new capital into the partnership, National Automotive Insurance.

On October 26, 1992, National Automotive Insurance was placed into rehabilitation under the direction and control of the Commissioner of Insurance. On December 17, 1992, an order approving the Joint Plan of Rehabilitation was issued, which ordered National Automotive Insurance be converted from a domestic Lloyd's Plan Insurer to a domestic stock insurer.

The new domestic stock insurer, National Automotive Insurance Company, was placed into rehabilitation. On February 10, 1993, National Automotive Insurance (the partnership) and National Automotive Insurance Company (the stock insurer) entered into an "Agreement of Assumption of Liabilities and Transfer of Assets" with an effective date of December 17, 1992.

During the period of rehabilitation the stock insurer's capitalization structure was modified and amended under Court Order. By Court Order dated March 3, 1995, the capital structure was again modified in recognition of an additional investment, which had the effect of increasing the capital and surplus of the new stock insurer above the

\$3,000,000 required for release from rehabilitation. By Court Order dated March 7, 1995, the new stock insurer was released from rehabilitation.

TERRITORY AND PLAN OF OPERATIONS

The Company is licensed to write business in both Louisiana and Mississippi. However, as of the examination date, the Company was writing only in the State of Louisiana. The Company's Certificate of Authority authorizes the writing of vehicle insurance. The Company markets Standard, Middle Standard and Non-Standard private passenger auto coverage.

The Company markets its business through approximately two hundred (200) independent producers or producer agencies with no authority to bind risks without prior authorization from the Company.

YEAR LA PREMIUMS WRITTEN*

2002	\$ 29,224,973
2003	25,845,699
2004	20,000,435

*Schedule T of the Annual Statements

AFFILIATE MANAGEMENT AND SERVICE AGREEMENTS

In December 2001 the Company entered into a Software Lease Agreement with Fidelity Insurance, LLC ("FI"), an affiliated company, as lessor and owner of the Oracle-based software that provided for a policy and claims management system for the automotive insurance business in connection with a Software License Agreement dated

May 16, 2001 with Systems Task Group, International Ltd. Stephen C. Schrempp, president of the Company is also President/Manager of FI.

The Software Lease Agreement had an effective date of January 1, 2002 and required payments of \$15,000 per month for thirty-six (36) months with an option that the lessor could purchase the software for \$100.00 at the end of the lease. On December 31, 2004, both parties agreed, in writing, to terminate this agreement.

Effective January 1, 2005, the term of the Software Lease Agreement with Fidelity Insurance was extended through December 31, 2005. The monthly payments were reduced to \$10,000 per month.

Fidelity Insurance, operating as a managing general agency, entered into an agreement with the Company on March 15, 1999 to provide claims and policy administration services on behalf of FI in connection with its obligations to Fidelity First Insurance Company. According to the addendum dated October 10, 2000, Fidelity Insurance, LLC compensated the Company for its services at eight percent (8%) of the earned premium less policy fees of each issued on behalf of Fidelity First Insurance Company. On December 31, 2004, both parties agreed, in writing, to terminate this agreement.

Effective January 1, 2005, the Company entered into a new agreement with Fidelity Insurance, LLC, whereas FI would adjust all Company claims on an exclusive basis. The Company would pay FI a fee for services rendered at a rate of seven percent (7%) of the paid losses amount per claims on all claims which arose from policies which were incepted January 1, 2001 and thereafter. The Company was required to pay Fidelity a fee for services rendered at a rate of twenty percent (20%) of the paid loss

amount per claim on all claims that arose out of policies which were inception prior to and including December 31, 2000. The Company also retains the services of Fidelity to adjust all claims on an exclusive basis beginning January 1, 2005 and continuing until termination of this agreement.

On March 7, 1995, the Company entered an agreement with Noble Claims Service, Inc., ("NCS") whereby NCS bound and obligated itself to adjust property damage and bodily injury claims arising out of the automotive policies of insurance issued by the Company to its policyholders. On December 31, 2004, both parties agreed, in writing, to terminate this agreement.

On March 7, 1995, the Company entered an agreement with Noble Claims Services, Inc., whereby The Company and NCS shared office expenses. On December 31, 2004, both parties agreed, in writing, to terminate this agreement.

On March 7, 1995, the Company entered an agreement with Insurance Funding Services, Inc., ("IFS") whereby IFS agreed to provide premium financing to purchasers of insurance for the benefit of the Company's policyholders. On December 31, 2004, both parties agreed, in writing, to terminate this agreement.

RECOMMENDATIONS FROM PRIOR EXAMINATION REPORTS

In the Louisiana Financial Examination Report as of December 31, 2001, it was recommended that the Company properly appoint its producers in accordance with **LSA-R.S. 22:1144**. This current examination also detected a number of unappointed producers. See Producer Review for details.

Also, it was recommended that the Company maintain a complaint register. The Company provided a complaint register that was in compliance with Louisiana Statutes.

Finally, it was noted that some of the Company's policy forms did not have a form number in the lower left-hand corner of each page. During the examination, the Company provided new business policies which indicated all policy forms had form numbers and the declaration page listed all policy forms that accompanied the new business policies.

COMPLAINT REVIEW

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

The Company had a small number of complaints during the period under examination. The Company's responses to the Department on these complaints were timely and appeared adequate.

The Company had no formal complaint procedures but personnel verbally explained the Company's procedures, which appeared appropriate for the timely processing of complaints. It is recommended that the Company develop written complaint procedures.

During the examination the Company provided a complaint register for the three (3)-year period, which was in compliance with the above Louisiana Statute.

PRODUCER REVIEW

The Company had no formal producer procedures for appointing or terminating its producers. Due to the condition of the Company's active producer file, it was necessary to verify all of the Company's active producers against the Department's

current list of appointments for the Company. It is recommended that the Company implement producer procedures that cover all producer activity with the Company.

This review resulted in the following exception: thirty-two (32) producers or producer agencies were paid commissions while being unappointed for part or all of the three (3) years under examination.

The Company provided a CD of commission records which contained the number of policies that commissions were paid to the detected, unappointed producers during the period May 2002 through December 2004. As a result of a change in commission systems, the commissions for the first four (4) months of 2002 were not extracted.

For the period May 2002 through December 2004, the Company paid commissions to thirty-two (32) unappointed producers or producer agencies. This resulted in thirty-two (32) violations of **LSA-R.S. 22:1144 B (3)** which states:

“Each insurer shall submit to the commissioner of insurance, in a manner prescribed by the commissioner, a list of appointed producers which it intends to appoint or reappoint. Each insurer shall remit, in a manner prescribed by the commissioner, appointment fees in the amount set forth in R.S. 22:1078. Any insurer who fails to file its renewal company appointments will be fined ten dollars per license named in its appointment form, or as otherwise authorized by R.S. 22:1078.

The Company was provided an exception report of the appointment and commission violations on April 25, 2005. The Company promptly responded that a procedure was being implemented whereby software will parallel the Department of Insurance’s website in verifying producer licenses. Also, once a quarter, the Company will verify all producer appointments.

The Company did not utilize the Department’s license number in its data base prior to this examination. During this review the license number was added to a list of

the Company's active producers in order to more easily verify the Company's appointments. The addition of the license numbers into the Company's data base was provided to the Company and should be a valuable aid in controlling producer appointments.

A sample of twenty (20) terminated producers was selected from a listing of terminated producers for the period under examination. The Company's reasons for terminating producers were primarily for non-compliance with underwriting guidelines, lack of business or poor claims experience. The Department was timely advised of terminations in accordance with Louisiana Statutes.

The Company was provided a copy of **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 and advised that its hiring practices of producers did not appear to be completely in compliance with this Louisiana Bulletin.

The Company responded it has complied with this Bulletin since June 1999. The Company's Employee's Manual did contain information relating to Louisiana Bulletin #99-01. Also, a form inquiring about criminal convictions is provided to all prospective producers.

ACL could not be used to test the Company's producer database because the Department's license number was not included. It is recommended that the Company add the Department producer license number to its database so that ACL can be utilized in future producer reviews.

MARKETING AND SALES REVIEW

The Company does not provide any sales material to its independent producer force. The only advertising conducted by the Company is an occasional sponsoring of a golf tournament. The Company has a website www.NationalAutomotiveInsurance.com which contains the Company's Private Passenger Automotive Rules and Rates, information on the Company's territory and a Severe Weather Advisory Line.

UNDERWRITING AND RATING REVIEW

The Company provided underwriting guidelines that appeared in accordance with policy provisions, statutes and regulations. The underwriting process requires that a completed Acord application be provided by the producer to the Company on a timely basis.

The Company provided a CD containing all new business and renewals for policies issued in 2002, 2003 and 2004 to Louisiana residents. ACL was utilized to select a random sampling of sixty (60) new business and renewal policies from the three (3) years under examination.

A review of this sampling indicated that Acord applications were complete and signed and dated by the applicant and the writing producer. Applications were processed on a timely basis. Copies of the Uninsured/Underinsured Motorist Bodily Injury Coverage Form (UMBI) were present in all files and initialed by the applicant. This form allows the applicant to record his or her selection or rejection of this coverage. No exceptions were detected during this review.

The Company provided a CD of non-renewed policies and cancelled policies for the three (3) year period under examination. ACL was utilized to select a random sampling of sixty (60) non-renewed or cancelled policies for review. The sampling

produced mixed results as many of the files sampled contained no activity relating to non-renewal or cancellation. Eight (8) policies from the sample of sixty (60) were non-renewed or canceled policies due to such reasons as non payment of premium, request by insured to cancel or excessive claims by insured. These eight (8) non-renewed or canceled policies were handled in accordance with policy provisions, statutes and regulations.

Since the Company could not identify this activity in its records, no additional samplings were attempted on this activity. The Company's failure to provide requested policy activity is a practice addressed in **LSA-R.S. 22:1214 (16)** which states in pertinent part as follows:

“Failure to maintain marketing and performance records Failure of an insurer to maintain its books, records, documents and other business records in such an order that data regarding complaints, claims, rating, underwriting, and marketing are accessible and retrievable for examination by the insurance commissioner...”

It is recommended that the Company implement enhancements in its underwriting system which will adequately identify non-renewal and cancellation activity for future examinations.

CLAIMS REVIEW

The Company provided claims procedures that appeared to be in accordance with policy provisions, statutes and regulations. A walk thorough of the Company's initial handling of claims was conducted at the Company's location in Metairie, Louisiana. Primarily, claims are received via the telephone and the claim data is recorded along with the date of the telephone call. A small number of claims are sent via facsimile to the

Company. Each facsimile reviewed, contained the date of communication. Any mailed claims are immediately date stamped by the mailroom.

The Company provided a CD of paid claims for 2004 per the examiner's request. After the total of the paid claims from the CD were reconciled with the Company's 2004 Annual Statement, ACL was utilized to select a random sampling of sixty (60) paid claims for review. The sampling contained six (6) claims that were denied or closed without payment claims.

The sampling indicated paid claims were paid in an average of fourteen (14) days. Due to the inability to select and extract different claim coverages, ACL was not used to generate a time study of all property paid claims in 2004. This sampling review indicated claims were paid in accordance with policy provisions, statutes and regulations.

Because the Company's claim system did not contain any codes which could be used to extract different types of denied claim activity, ACL was used to try and isolate denied claims or claims closed without payment by extracting claims with a zero or blank in the paid column in the 2004 claim file. This approach generated forty-four (44) denied and claims closed without payment and sixteen (16) paid claims.

The review of these forty-four (44) sampled claims revealed denials due to no coverage, opposing driver was at fault (opposing driver's insurance paid), the insured elected not to pursue the claim and property damages were less than the policy deductible. This review indicated claims were denied or closed without payment in accordance with policy provisions, statutes and regulations.

The Company's failure to provide certain claim activity is a practice addressed in **LSA-R.S. 22:1214 (16)**, which states in pertinent part as follows:

“Failure to maintain marketing and performance records Failure of an insurer to maintain its books, records, documents and other business records in such an order that data regarding complaints, claims, rating, underwriting, and marketing are accessible and retrievable for examination by the insurance commissioner...”

It is recommended that the Company implement enhancements in its claims system which will adequately identify paid, denied and claims closed with payment for future examinations.

The Company has an agreement with Southern Gulf (“SG”) located in Baton Rouge, Louisiana in which SG handles body injury claims that occur in the southwestern part of the State of Louisiana.

The Company has a fraud prevention program in place. Claims adjusters are trained in new fraud techniques currently employed by perpetrators of fraud. All suspicious claims and all stolen vehicles are reported to the NICB. If an adjuster suspects claim fraud, he or she consults with a supervisor who will report to the Company’s fraud examiner.

If a claim is denied due to fraud, it is reported to the Department of Insurance as well as the State Police Insurance Fraud Unit. All evidence is presented and certified by affidavit so the State Police can take the documentation directly to the District Attorney in the appropriate parish for further review and charges.

CONSUMER PRIVACY POLICY REVIEW

The Company's privacy and confidentiality policy and procedures in place to secure information regarding policyholders and claimants, was not completely in compliance with the Louisiana Department of Insurance **Regulation 76 / *PRIVACY OF CONSUMER FINANCIAL INFORMATION***.

Although the Company provides a Privacy Notice with each new business issued, no follow up notices are mailed. The Company agreed to send annual Privacy notices to those policyholders who renew their coverage.

COMMENTS AND RECOMMENDATIONS

The Company provided timely responses to the examination requests submitted during this examination.

PRODUCER REVIEW

The Company had no formal procedures for appointing or terminating its producers. It is recommended that the Company implement procedures that cover all producer activity with the Company.

For the period May 2002 through December 2004 the Company paid commissions to thirty-two (32) producers or producer agencies. This resulted in thirty-two (32) violations of **LSA-R.S. 22:1144 B (3)**, which states:

“Each insurer shall submit to the commissioner of insurance, in a manner prescribed by the commissioner, a list of appointed producers which it intends to appoint or reappoint. Each insurer shall remit, in a manner prescribed by the commissioner, appointment fees in the amount set forth in R.S. 22:1078. Any insurer who fails to file its renewal company appointments will be fined ten dollars per license named in its appointment form, or as otherwise authorized by R.S. 22:1078.

ACL could not be used to test the Company’s producer database because the Department’s license number was not included. It is recommended that the Company add this license number to its database so that ACL can be utilized in future producer reviews.

UNDERWRITING AND RATING REVIEW

The Company’s failure to provide requested policy activity is a practice addressed in **LSA-R.S. 22:1214 (16)** which states in pertinent part as follows:

“Failure to maintain marketing and performance records Failure of an insurer to maintain its books, records, documents and other business records in such an order that data regarding complaints, claims, rating, underwriting, and marketing are accessible and retrievable for examination by the insurance commissioner...”

It is recommended that the Company implement enhancements in its underwriting system which will adequately identify non renewal and cancellation activity for future examinations.

CLAIMS REVIEW

The Company’s claims system did not provide any codes for certain claims activity such as paid claims, claims denied and claims closed without payment. Consequently, this activity could not be accurately extracted by ACL for proper sampling and review.

The Company’s failure to provide certain claims activity is a practice addressed in **LSA-R.S. 22:1214 (16)** which states in pertinent part as follows:

“Failure to maintain marketing and performance records Failure of an insurer to maintain its books, records, documents and other business records in such an order that data regarding complaints, claims, rating, underwriting, and marketing are accessible and retrievable for examination by the insurance commissioner...”

It is recommended that the Company implement enhancements in its claims system which will adequately identify paid, denied and claims closed with payment for future examinations.

CONSUMER PRIVACY POLICY REVIEW

Although the Company provides a Privacy Notice with each new policy issued, no follow up notices are mailed. The Company agreed to send annual Privacy notices to those policyholders who renew their coverage.

It is recommended that the Company implement procedures that assure that Privacy Notices are mailed out in accordance with **Regulation 76 / *PRIVACY OF CONSUMER FINANCIAL INFORMATION***.

CONCLUSION

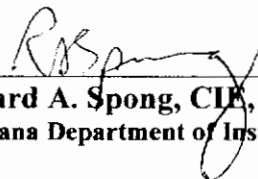
I, Richard A. Spong, do solemnly swear and affirm that I am an examiner for the Commissioner of Insurance of the State of Louisiana and that as such I was assigned to conduct an examination of the market conduct activities of

NATIONAL AUTOMOTIVE INSURANCE COMPANY

METAIRIE, 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

Respectfully submitted,



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