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MARKET CONDUCT EXAMINATION REPORT OF

20th CENTURY INSURANCE COMPANY (NAIC # 12963) & 21st CENTURY CASUALTY COMPANY (NAIC # 36404)

WOODLAND HILLS, CALIFORNIA

STATE OF CALIFORNIA

DEPARTMENT OF INSURANCE

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CONFIDENTIALITY STATEMENT

The Market Conduct Examination Report contained herein, including any addendum hereto, is CONFIDENTIAL unless and until the Insurance Commissioner, by the authority vested in him or her pursuant to Section 735.5 of the California Insurance Code, determines otherwise.

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INTRODUCTION

This report developed by the Market Conduct examiners is a report written by exception. Findings as respects claim files reviewed which did not reflect deficiencies were omitted. The report contains only pertinent information about the categories of claims examined and the details of non-compliant or problematic activities discovered during the course of the examination.

AUTHORITY

The Market Conduct Examination of 20th Century Insurance Company and 21st Century Casualty Company (hereinafter referred to as "20th" and "21st" respectively or "the Companies") was conducted pursuant to the authority granted under Part 2, Chapter 1, Article 4, Sections 730, 733, 736, and Article 6.5, Section 790.04 of the California Insurance Code; and Title 10, Chapter 5, Subchapter 7.5, Section 2695.3(a) of the California Code of Regulations.

DURATION OF EXAMINATION

The on-site examination of claim files was conducted from January 26 through March 17, 1998 at the Companies' regional claims office located at 1800 E. Imperial Highway, Brea, California and continued periodically (off-site) through September 1, 1998.

PURPOSE OF EXAMINATION

This examination was conducted for the purpose of evaluating the Companies' compliance with contractual obligations, its own procedures, the California Insurance Code, the Unfair

Claims Settlement Practices Regulations, Fair Claims Practices Regulations (as applicable), applicable case law, and applicable legal requirements.

This examination was conducted to review the Companies' claim handling practices as respects claims presented for losses incurred as a result of the California earthquake of January 17, 1994, also known as The Northridge Earthquake.

COMPANY PROFILE

20th Century Insurance Company was incorporated under the laws of California on Nov. 1, 1967 and began business on Dec. 31, 1968. 21st Century Casualty Company was incorporated under the laws of California on Sept. 8, 1987 and began business on Jan. 4, 1988. All of the outstanding capital stock of the group is owned by 20th Century Industries, a publicly held insurance holding company. The majority shareholders of the holding company are American International Group (42%), The DeNault Family (6.3%), The Foster Family (5.8%), and Union Automobile Insurance Group (5.5%).

The 20th Century Insurance Group primarily markets, on a direct basis, personal automobile and excess liability policies in the State of California (exclusively) where, according to the 1997 edition of Best's Insurance Reports - Property/Casualty, it ranks as **the fifth largest personal automobile carrier**. The same source indicates that **preferred private automobile Insurance represents about ninety-five percent of the group's total business**. A copy of the referenced report is included as **Exhibit I-1**. Direct premium writings for the year 1996 are as follows:

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Company	Product Line	Total Direct Premium	Percentage of Written Premium
20th	Private Passenger Auto Liability	$544,204,000	63.0%
	Auto Physical	294,000,000	33.9%
	Homeowners	33,000,000	3.0%
	All Other	2,796,000	0.1%
	Total	**$804,807,000**	**100.0%**
21st	Private Passenger Auto Liability	35,383,000	64.3%
	Auto Physical	18,482,000	33.6%
	Homeowners	1,132,000	2.0
	All Other	39,000	0.1
	Total	**$55,036,000**	**100.0%**

CLAIMS OPERATION

A copy of the Companies' Catastrophe Handling Guidelines and a copy of the Basic Earthquake Catastrophe Procedures are included as **Exhibits I-2** and **I-3** respectively.

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SCOPE OF EXAMINATION

The examiners reviewed 431 files drawn from populations of Northridge earthquake claims processed at the Companies' claims locations. Representative samples were selected as follows:

20th CENTURY

Category	Population	Sample
Homeowners EQ Paid	26,038	80
Homeowners EQ CWP/Denied	5,134	78
Open Homeowners	300	76
Total	**31,472**	**234**

21st CENTURY

Category	Population	Sample
Condo EQ Paid	4,345	81
Condo EQ CWP/Denied	315	63
Open Condo	53	53
Total	**4,713**	**197**

Actual file selection was accomplished through the Market Conduct Bureau's automated random sampling program.

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GLOSSARY

For the purpose of this examination, and particularly within the context of discussions in the Findings section, the following terms are defined:

ACV: Actual Cash Value

ALE: Additional Living Expense

CDI: California Department of Insurance

CIC: California Insurance Code

CWP: Closed Without Payment

Delay: Claims handling must reflect compliance with standards of timeliness contained in the Unfair Claims Settlement Practices Regulations and/or the Fair Claims Settlement Practices Regulations as applicable. Specified types of processing transactions enumerated in the Regulations (e.g., acknowledgment and payment) are to be handled **immediately**, but in no event beyond the maximum number of days allowed in each case.

EQ: Earthquake

Error: Any violation or act of non-compliance with the UCP or FCP Regulations or 790.03(h): or violation or act of non-compliance or act prohibited by the CIC.

Examiners: CDI/Market Conduct Bureau personnel

Faulty Documentation: Absence of billings, drafts, letters, diary notes, date stamps and other essential information substantiating the handling or disposition of the claim; the inclusion of material not related to the file; the misdirection of correspondence (including form letters) to parties involved in the settlement process; the failure to fully comply with existing CDI regulatory requirements pertaining to documentation.

FCP Regulation(s): Fair Claims Settlement Practices Regulations, CIC Title 10, Chapter 5, Subchapter 7.5, effective 5/10/97.

HO: Home Owner (Policy).

HOA: Homeowners Association.

IA: Independent Adjuster.

Improper Settlement: Any questionable practice employed to deny or limit coverage or settlement; the failure to investigate claims and defend or indemnify the insured; the failure to apply consistent standards and procedures; payment inaccuracies; the failure to comply with all applicable CDI Regulations regarding full disclosure of benefits, coverages, time limits or other policy provisions.

TLEA: Temporary Living Expense Allowance.

UCP Regulation(s): Unfair Claims Settlement Practices Regulations, of the California Code of Regulations, Title 10, Chapter 5, Subchapter 7.5 effective prior to 5/10/97.

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EXECUTIVE SUMMARY

(OVERVIEW OF FINDINGS)

As indicated in the **Scope of the Examination** section, the **Market Conduct staff** examiners **reviewed 431 claim files in which 875 claims handling violations of the UCP Regulations and/or CIC** were identified **within 324 files**. While deficiencies were noted in all samples reviewed, the majority of significant errors were primarily discovered in the "Paid and Open Homeowners and Condominium" samples. Significant errors indicative of improper claims handling include: inadequate investigations and scoping of damages; low settlement offers; unsupported depreciation reductions (applicable to other than Coverage "A" structure damage); failure to explain settlement reductions; improper denial of claims based on Companies' improper application of the one year limitation regarding the suit provision of the policy; failure to clearly explain policy provisions to insureds; confusing and ambiguous form letters; failure to correctly pay debris removal claims and imposing the one year limitation to examiners' requests for payment of this benefit; failure to respond in a timely manner to examiners' inquiries; inclusion of misleading reference to "full and final" payment on claim checks.

The findings of this examination indicate that the Companies' practices affect all first party property losses and are not necessarily exclusive to earthquake claims.

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While specific citations are identified in the **Specific Findings** section of this report, the following is a statistical overview:

Category	No. Of Files	No. Of Files With Citations	No. Of Citations
20th HO Paid	80	65	142
20th HO Open	76	59	163
20th HO CWP	78	51	62
21st Condo Paid	81	72	244
21st Condo Open	53	46	215
21st Condo CWP	63	31	49
Total:	431	324	875

The following is an overview of citations:

TABLE OF TOTAL CITATIONS			
	CIC or UCP Description	20th Century Insurance Company Number of Citations	21st Century Casualty Company Number of Citations
2695.6(a) & 790.03(h)(3) & 790.03(h)(5)	Company failed to perform necessary, proper, timely investigation	65	63
2695.4(a) & 790.03(h)(1)	Company failed to clearly explain or document explanation of all benefits, coverages and time limits of policy.	115	77
2695.7(g) & 790.03(h)(5), 790.03(h)(1), 790.03(h)(3) and/or 2695.4(a),and/or 790.03(h)(15)	Low settlement/failure to effectuate prompt, fair, equitable settlement.	52	86

2695.4(a)& 790.03(h)(1)	Company misrepresented pertinent facts or policy provisions i.e. misleading language;vague statements; misrepresentation of settlement terms	32	141
2695.3(a) & 7909.03(h)(3)	Documentation Error. Claim file does not contain all documents, notes, work papers, and dates of pertinent events.	25	80
2695.3(a) & 790.03(h)(3) & 790.03(h)(5)	Unsupported Depreciation reduction.	28	0
2695.4(a) & 790.03(h)(1) & 790.03(h)(3)	Failure to explain settlement reductions.	28	0
2695.3(b)(2) & 790.03(h)(3)	Claim file does not record date material or relevant document transmitted, processed or received.	3	10
2695.5(a) & 790.03(h)(2) & 790.03(h)(3)	Company failed to acknowledge notice of claim immediately, but in no event later than 15 calendar days .	1	1
2695.5(f) & 790.03(h)(2) 790.03(h)(3)	Company failed to respond timely to CDI inquiry.	0	31
2695.5(g) & 790.03(h)(2) & 790.03(h)(3)	Company failed to respond to communication within 15 calendar days.	2	4
2695.7(b) & 790.03(h)(4)	Company did not accept or deny within 40 calendar days.	1	10
2695.7(b)(1) & 790.03(h)(3)	Factual basis for denial not stated in writing.	1	0
2695.7(c)(1) & 790.03(h)(3)	Failure to notify claimant additional time needed to investigate claim.	4	1

2695.7(h) & 790.03(h)(5)	Company did not tender-payment within 30 days of accepting claim.	6	2
2695.7(l) & 790.03(h)(3)	Company denied claim on basis of undocumented telephone call.	4	2
Total Citations		367	508

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SUMMARY OF CRITICISMS and INSURER COMPLIANCE ACTIONS

The following is a brief summary of the major criticisms that were developed during the course of this examination. In response to each criticism, the Companies are required to identify remedial/corrective action(s) that has/have been or will be taken to correct the deficiency. Regardless of the remedial actions taken or proposed by the Companies, it is the Companies' obligation to ensure that compliance is achieved.

1.. **Inadequate Investigation/Inspection** The examiners cited **128** instances in which the Companies failed to perform fair, adequate, correct and/or timely estimating of the insured's damages. These inspections were primarily conducted by IA's, employed by the Companies, who, in many instances, did not possess the appropriate level of training and lacked the support of definitive guidelines and procedures to ensure quality and timely inspections. Files in which damages were grossly underestimated by the Companies' representatives indicate, in many instances, minimal inspections of crawl spaces, foundations, or attics. Many files reveal: 1) insureds were required to request additional inspections (especially) when confronted with estimates by contractors (hired by the insured) indicating damages substantially exceeded the Companies' original settlement offers; 2) as a result of improper investigations, initial settlements were unreasonably low in some instances; 3) in some cases insureds were advised erroneously that damages were below the deductible; 4) the Companies failed to investigate ownership of fences prior to settlement (assuming common ownership in all cases). The Companies' position on common walls is set forth in **Exhibit I- 8.**

While the examiners recognize the possibility of hidden damage and the effects of after-shocks, there is substantial evidence to indicate insufficient investigations and gross oversight on the part of the Companies. It should be noted that the Companies, in several files, recognized the inadequacies and lack of expertise of the initial adjusters and referred

the claims to a construction consulting firm to utilize their technical expertise. This approach, however, does not appear to have been instituted until sometime in 1995. While a number of claims were eventually settled at a higher amount than the original offer, it was noted that many of these settlements were driven by the **insured** requesting reinspection. In some instances, multiple reinspections were required in order to reach a final settlement. Additionally, the Companies' failure to perform adequate investigations resulted in delays in claims settlements. These acts are violations of UCP Regulation2695.5(a), 790.03(h)(3); 790.03(h)(5)

Remedial Action: To be determined.

2. **Improper/Low Settlements:** The examiners cited **138** instances in which the Companies failed to settle claims properly as described in the following paragraphs:

a. Inadequate inspection of damages resulted in 36 instances of unreasonably low settlement offers. Additionally, it was the Companies' procedure not to apply depreciation to block walls. However, the examiners were advised that some of the IA's were unaware of this policy. This deficiency was the subject of several referrals of individual files by the examiners resulting in supplemental payments to insureds. These acts are violations of UCP Regulation 2695.7(g) and CIC 790.03(h)(5).

b. The Companies improperly denied 46 claims on the grounds that the "time" to file a suit (against the Companies) had expired. The Companies improperly established the "inception" of loss date as 1/17/94 (the date of the Northridge EQ) thereby failing to consider the date "appreciable damage" was discovered by the insured and issue appropriate settlement payments. The Companies' position is unreasonable absent any effort to determine when a reasonable insured would have discovered appreciable damage.

It should be noted that the Companies adopted an Alternative Dispute Resolution (ADR) procedure as of September 1997. See **Exhibit I-5.** Under this procedure, denial letters continue to state that the claims are time barred however, the insured is offered the opportunity to contact Company counsel to discuss the denial. In a number of cases where the insured (apparently) contacted Company counsel, a settlement was reached in exchange for a "Full Release" **Exhibit I-12.. Information as to the content and nature of these negotiations was not available in the claim files.** When questioned by the examiners as to the reason(s) for instituting this process, management indicated the primary goal is to minimize the time and expense associated with litigation. **Additionally, the examiners find the Companies' practice of requiring a Full Release of All Claims under the ADR program is highly questionable.** The release appears complex, lengthy and overly broad

The Companies' ADR program: 1) fails to address the issue of the Companies improper application of the statute of limitations; 2) fails to provide an adequate remedy to all insureds affected by the Companies improper denials; 3) is limited in scope to only those insureds whose claims were "improperly" denied as of September 1997; and 4) fails to meet the Companies responsibilities to its insureds. Further, the lack of documentation and file notations outlining the basis of any settlement resulting from ADR program prohibited the examiners from making a determination as to whether or not the insureds received fair settlements. The Companies' acts are violations of CIC sections 790.03(h)(5), 790.03(h)(3), 790.0(3)(h)(1), 790.0(3)(h)(15) & UCP Reg. 2695.4(a). The Companies' position is enunciated in **Exhibit I-4.**

c. The examiners noted 56 instances in which 21st Century failed to properly settle claims involving coverage for debris removal as the adjusters failed to include an additional 5% when the dwelling limit was paid. The examiners referred a number of files to Company management for supplemental payments. In some cases additional payments

were issued, however in other cases the Company refused to consider further action stating that CDI's request was "time barred". See **Exhibit I-6.**

The failure of the Company to effectuate appropriate settlements both when the claims were originally processed and when the files were referred by the examiners generates multiple violations including, CIC section 790.03(h)(5) & UCP Regulation 2695.7(g); UCP Regulation 2695.3(a)); UCP Regulation 2695.5(f); UCP Regulation2695.6(a) & CIC sections 790.03(h)(3); 790.03 (h)(1)) & UCP Regulation 2695.4(a).

These issues are herein referred to the CDI Legal Division for review, opinion and appropriate action.

Remedial Action: To be determined.

3. **Failure to Explain Policy Benefits:** In 192 instances the Companies failed to definitively disclose provisions, benefits, and/or time limits to insureds or did not adequately document disclosure. This includes the use of a form letter indicating that there **'may'** be coverage for ensuing damage. Illustrative of this deficiency is the letter designated as **Exhibit I-7.** This language is vague and equivocal. Additionally, in many cases the examiners could not determine what information had been disclosed to the insured. These acts are violations of UCP Regulation 2695.4(a) and CIC section 790.03(h)(1).

Remedial Action: To be determined.

4. **Misrepresenting Pertinent Facts and Policy Provisions Relating to Coverage at Issue.** The examiners discovered **173** instances of misrepresentation of pertinent facts and/or policy provisions. The examiners noted: 1) closing letters to insureds failed to explain the settlement or identify the date the one year submission of claim had or would expire; 2) form

letters were confusing in that one paragraph indicates payment was in fact issued while a separate paragraph states that the claim is below the deductible. Additionally, settlement checks were issued containing the words **"full and final settlement"** even though this was not necessarily true. See **Exhibit I-9.** It is the Companies' position that such language would not preclude consideration of a supplemental claim **if submitted**. However, the examiners find this language clearly states that the settlement **is final** and insureds may logically believe they are, in fact, prohibited from pursuing additional or newly discovered damages. It should be noted that the Companies recognized the problem regarding the **"full and final"** wording and this language was deleted from the checks prior to the on-site examination. The examiners find: 1) this remedial action only affects claims paid after the Companies remedial action was implemented; 2) only affected earthquake claims; 3) does not provide remedial action for those insureds whose claims were adjudicated prior to the Companies remedial action.

These acts are violations of UCP Regulation 2695.4(a) & CIC Section 790.03(h)(1).

Remedial Action: To be determined.

5. **Unsupported Depreciation:** While depreciation was only applied to **"other structures" and "contents"**, the examiners noted 28 instances of unsupported reductions in settlements. The files do not contain justification or any basis to indicate that the depreciation applied was discernible, measurable and fair. It is evident that appropriate training, standards and quality control procedures are not in place. These actions are violations of UCP Regulation 2695.3(a), CIC 790.03(h)(5) & 790.03(h)(3).

Remedial Action: To be determined.

6. **Lack of Explanation of Settlement Reductions:** In 28 instances the Companies failed to explain depreciation reductions to policyholders. These acts are violations of UCP Regulation 2695.4(a) and CIC 790.03(h)(1); 790.03(h)(3).

7. **Failure to Document Files and Date Stamp Correspondence:** The Companies failed to properly document files and/or date stamp correspondence in 118 instances (13 failure to date stamp errors included). Pertinent correspondence is missing from the files or there is a lack of documentation of events such as the date IA's were assigned to claims. These acts are violations of UCP Regulation 2695.3(a) and CIC 790.03(h)(3); and 2695.3(b)(2) and CIC 790.03(h)(3)

Remedial Action: To be determined.

8. **Failure to Tender Payment Within 30 Days:** In 8 instances, the Companies failed to tender payment immediately or within 30 days indicating a lack of proper procedures for the on-going monitoring of active files. These acts are violations UCP Regulation 2695.7(h) and CIC 790.03(h)(5)

Remedial Action: To be determined.

9. **Failure to Accept or Deny Claim Within 40 Days:** In 11 instances, the Companies failed to accept or deny claims immediately or within 40 days of receipt of proof. As indicated in item 8 above, this indicates a lack of appropriate file monitoring procedures. These acts are violations of UCP Regulation 2695.7(b) and CIC 790.03(h)(4).

Remedial Action: To be determined.

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10. <u>Status Letters</u>: In 5 instances, the Companies failed to advise insureds that additional time was needed to investigate claims. As previously mentioned above, this indicates a lack of appropriate file monitoring procedures. These acts are violations of UCP Regulation 2695.7(c)(1) and CIC 790.03(h)(3).

Remedial Action: To be determined.

11. **Failure to Document Telephone Conversations As a Basis For Claim Denial:** In 6 instances, the Companies failed document telephone conversations used as the basis for claim denials. These acts are violations of UCP Regulation 2695.7(l) and CIC 790.03(h)(13)

Remedial Action: To be determined.

12. **Failure to Respond to CDI Request for Further Investigation:** During the examination, certain files were referred to the Companies for further investigation. **(See Ex. I-11).** The Companies have not responded to the CDI request and the disposition of these claims remains unknown. These acts are violations of FCP Regulation 2695.5(a)

Remedial Action. To be determined.