

STATE OF ARIZONA
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DEPT. OF INSURANCE

REPORT OF TARGET MARKET CONDUCT EXAMINATION

OF

AMERICAN COMMERCE INSURANCE COMPANY

NAIC #19941

AS OF

December 31, 2007

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CHRISTINA URIAS
Director of Insurance

Honorable Christina Urias
Director of Insurance
State of Arizona
2910 North 44th Street
Suite 210, Second Floor
Phoenix, Arizona 85108-7256

Dear Director Urias:

Pursuant to your instructions and in conformity with the provisions of the Insurance Laws and Rules of the State of Arizona, a desk examination has been made of the market conduct affairs of the:

AMERICAN COMMERCE INSURANCE COMPANY
NAIC #19941

The above examination was conducted by Helene I. Tomme, CPCU, CIE, Market Examinations Supervisor, Examiner-in Charge, and Linda L. Hofman, AIE, MCM, FLMI, AIRC, CCP, Market Conduct Senior Examiner and Christopher G. Hobert, CIE, MCM, FLMI, AIRC, CCP, Market Conduct Senior Examiner.

The examination covered the period of January 1, 2007 through December 31, 2007.

As a result of that examination, the following Report of Examination is respectfully submitted.

Sincerely yours,

Helene I. Tomme, CPCU, CIE
Market Examinations Supervisor
Market Oversight Division

AFFIDAVIT

STATE OF ARIZONA)
) ss.
County of Maricopa)

Helene I. Tomme, CPCU, CIE being first duly sworn, states that I am a duly appointed Market Examinations Examiner-in-Charge for the Arizona Department of Insurance. That under my direction and with my participation and the participation of Linda L. Hofman, AIE, MCM, FLMI, AIRC, CCP, Market Conduct Senior Examiner and Christopher G. Hobert, CIE, MCM, FLMI, AIRC, CCP, Market Conduct Senior Examiner on the Examination of American Commerce Insurance Company, hereinafter referred to as the "Company" was performed at the office of the Arizona Department. A teleconference meeting with appropriate Company officials in Columbus, Ohio, and Webster, Massachusetts was held to discuss this Report, but a copy was not provided to management as the Examination was incomplete and had not yet been finalized. The information contained in this Report, consists of the following pages, is true and correct to the best of my knowledge and belief and that any conclusions and recommendations contained in and made a part of this Report are such as may be reasonably warranted from the facts disclosed in the Examination Report.

Helene I. Tomme
Helene I. Tomme, CPCU, CIE
Market Examinations Supervisor
Market Oversight Division

Subscribed and sworn to before me this 6th day of October, 2008.

Elizabeth L. Sickinger
Notary Public

My Commission Expires Jan. 17, 2009



FOREWORD

This targeted market conduct examination report of American Commerce Insurance Company (herein referred to as, "ACIC", or the "Company"), was prepared by employees of the Arizona Department of Insurance (Department) as well as independent examiners contracting with the Department. A market conduct examination is conducted for the purpose of auditing certain business practices of insurers licensed to conduct the business of insurance in the state of Arizona. The Examiners conducted the examination of the Company in accordance with Arizona Revised Statutes (A.R.S.) §§ 20-142, 20-156, 20-157, 20-158 and 20-159. The findings in this report, including all work product developed in the production of this report, are the sole property of the Department.

The examination consisted of a review of the following Private Passenger Personal Automobile (PPA) and Homeowners (HO) lines of business operations:

1. Complaint Handling
2. Marketing and Sales
3. Producer Compliance
4. Underwriting and Rating
5. Cancellations and Non-Renewals
6. Claims Processing

Certain unacceptable or non-complying practices may not have been discovered in the course of this examination. Additionally, findings may not be material to all areas that would serve to assist the Director.

Failure to identify or criticize specific Company practices does not constitute acceptance of those practices by the Department.

SCOPE AND METHODOLOGY

The examination of the Company was conducted in accordance with the standards and procedures established by the National Association of Insurance Commissioners (NAIC) and the Department. The market examination of the Company covered the period of January 1, 2007 through December 31, 2007 for business reviewed. The purpose of the examination was to determine the Company's compliance with Arizona's insurance laws, and whether the Company's operations and practices are consistent with the public interest. This examination was completed by applying tests to each examination standard to determine compliance with the standard. Each standard applied during the examination is stated in this report and the results are reported beginning on page 8.

In accordance with Department procedures, the Examiners completed a Preliminary Finding ("Finding") form on those policies, claims and complaints not in apparent compliance with Arizona law. The finding forms were submitted for review and comment to the Company representative designated by Company management to be knowledgeable about the files. For each finding the Company was requested to agree, disagree or otherwise justify the Company's noted action.

The Examiners utilized both examinations by test and examination by sample. Examination by test involves review of all records within the population, while examination by sample involves the review of a selected number of records from within the population. Due to the small size of some populations examined, examination by test and by sample were completed without the need to utilize computer software.

File sampling was based on a review of underwriting and claim files that were systematically selected by using Audit Command Language (ACL) software and computer data files provided by the Company. Samples are tested for compliance with standards established by the NAIC and the Department. The tests applied to sample data will result in an exception ratio, which determines whether or not a standard is met. If the exception ratio found in the sample is, generally less than 5%, the standard will be considered as "met." The standard in the areas of procedures and form use will not be met if any exception is identified.

HISTORY OF THE COMPANY

(Provided by the Company)

American Commerce Insurance Company ("ACIC" or "The Company") provides property and casualty personal lines insurance in the state of Arizona. Policy types include private passenger automobile, boat, homeowners, mobile home, condominium, renters, dwelling fire and umbrella.

ACIC's home office is located in Columbus, Ohio and its Southwest Regional Claims office is located in Phoenix, Arizona.

The Company was incorporated on September 18, 1946 under the laws of Ohio as Automobile Club Insurance Company and began business on March 19, 1947. In December 1988, the Company was purchased by the American Automobile Association and California State Auto Association who maintained ownership until January 1999. In January 1999, the Company was sold to ACIC Holding Co., Inc., ("ACIC Holding"), which was formed on November 2, 1998. The Company changed its name from Automobile Club Insurance Company to American Commerce Insurance Company on February 22, 1999. Effective January 1, 2002, the ownership interests in ACIC Holding were recapitalized. At December 31, 2001, The Commerce Insurance Company ("Commerce") maintained an 80% common stock interest and AAA Southern New England ("AAA SNE") maintained a 20% common stock interest in ACIC Holding. Additionally, all ACIC holding preferred stock was owned by Commerce. The recapitalization resulted in redeeming of all the ACIC holding preferred stock by Commerce in exchange for 3,000 additional shares of ACIC Holding Common Stock. This resulted in Commerce increasing its ACIC holding common stock interest to 95% with AAA SNE maintaining a 5% ACIC Holding common stock interest. The recapitalization also resulted in the creation of \$4.5 million in minority interest for AAA SNE. In 2003, Commerce's 95% ownership interest in ACIC Holding was transferred to Commerce Holding, Inc., and affiliated company, as part of a corporate reorganization.

On October 30, 2007, The Commerce Group, Inc., the ultimate parent of the Company, entered into an Agreement and Plan of Merger with MAPFRE S. A. a Spanish corporation. At a

special meeting held on February 14, 2008, the shareholders of The Commerce Group, Inc. voted to approve the October 30, 2007 Agreement and Plan of Merger. On June 4, 2008, MAPFRE S.A. and its subsidiary, Magellan Acquisition Corp., completed the merger with and into The Commerce Group, Inc. ("Commerce"), with Commerce as the surviving corporation (the "Merger"). As the corporation surviving the Merger, Commerce, its affiliates and subsidiaries, including American Commerce Insurance Company, became indirect subsidiaries of MAPFRE, and MAPFRE's Ultimate Controlling Person, Fundacion MAPFRE.

PROCEDURES REVIEWED WITHOUT EXCEPTION

The Examiners review of the following Company departments¹ or functions indicates that they appear to be in compliance with Arizona statutes and rules:

Complaint Handling

Marketing and Sales

Producer Compliance

Underwriting and Rating

Claims Processing

EXAMINATION REPORT SUMMARY

The examination revealed one (1) compliance issues that resulted in 10 exceptions due to the Company's failure to comply with statutes and rules that govern all insurers operating in Arizona. These issues were found in one (1) of the six (6) sections of Company operations examined. The following is a summary of the Examiners' findings:

Cancellation and Non Renewals

In the area of Cancellations and Non Renewals, one (1) compliance issue is addressed in this Report as follows:

- The Company failed to include the required 45-day advance notice of non renewal on 10 PPA Non Renewals.

¹ If a department name is listed there were no exceptions noted during the review.

FACTUAL FINDINGS

RESULTS OF PREVIOUS MARKET CONDUCT EXAMINATIONS

During the past three (3) years, there were two (2) Market Conduct Examinations completed by the states of Kentucky and Washington. There were no significant patterns of non-compliance noted.

CANCELLATIONS AND NON-RENEWALS

Private Passenger Automobile (PPA):

The Examiners reviewed 52 PPA cancellation files for non-pay/declinations (including 2 sample files) and 54 PPA cancellations for underwriting reasons (including 4 sample files) out of a population of 1,224, and 11 PPA non renewal files (including 2 sample files) out of a population of 11. This cancellation/non renewal review included a total sample size of 117 PPA files from a total population of 1,235.

Homeowners (HO):

The Examiners reviewed 54 HO cancellation files for non-pay/declinations (including 4 sample files) and 52 HO cancellation files for underwriting reasons (including 2 sample files) out of a population of 1,507, and 52 HO non renewal files (including 2 sample files) out of a population of 121. This cancellation/non renewal review included a total sample size of 158 HO files from a total population of 1,628.

All cancellation and nonrenewal files were reviewed to ensure compliance with Arizona Statutes and Rules.

The following Cancellation and Non Renewal Standard was met:

#	STANDARD	Regulatory Authority
1	Declinations, Cancellations and Non-Renewals shall comply with state laws and company guidelines including the Summary of Rights to be given to the policyholder and shall not be unfairly discriminatory.	A.R.S. §§ 20-448, 2108, 20-2109, 20-2110

The following Cancellation and Non Renewal Standard failed:

#	STANDARD	Regulatory Authority
2	Cancellation and Non-Renewal notices comply with state laws, company guidelines and policy provisions, including the amount of advance notice required and grace period provisions to the policyholder and shall not be unfairly discriminatory.	A.R.S. §§ 20-191, 448, 1631, 20-1632, 20-1632.01, 1651 through 1656

Cancellation and Non-Renewal Standard #2 failed:

Preliminary Finding 004 – 45-day advance notice of non renewal – The Examiners identified 10 PPA policies that failed to provide the required 45-days advance mailing before the non renewal takes effect, an apparent violation of A.R.S. §§ 20-1631 and 20-1632.

PRIVATE PASSENGER AUTOMOBILE NON RENEWALS

Failed to include required 45-days advance notice

A.R.S. §§ 20-1631 and 20-1632

Population	Sample	# of Exceptions	% to Sample
11	11	10	91%

A 91% error ratio does not meet the Standard; therefore, a recommendation is warranted.

Recommendation #1

Within 90 days of the filed date of this Report provide the Department with documentation that Company procedures are in place to include the required 45-days advance notice to insureds of its intent to non renew personal automobile policies.

Subsequent Events: During the course of the Phase I Examination, the Company agreed with the Examiner's findings advising that the failure to provide the required 45-day advance notice of non renewal was the result of a system programming error that works in conjunction with its system table entries. It appears its system was programmed to give the required 45-day advance notice but failed to do so. On September 11, 2008, the Company advised that it had corrected the error and is running subsequent tests to ensure compliance.

SUMMARY OF FAILED STANDARDS

EXCEPTIONS	Rec. No.	Page No.
CANCELLATIONS AND NON RENEWALS		
<u>Standard #2</u> Cancellation and Non-Renewal notices comply with state laws, company guidelines and policy provisions, including the amount of advance notice required and grace period provisions to the policyholder and shall not be unfairly discriminatory.	1	12

SUMMARY OF PROPERTY AND CASUALTY STANDARDS

Complaint Handling

#	STANDARD	PAGE	PASS	FAIL
1	The company takes adequate steps to finalize and dispose of the complaints in accordance with applicable statutes, rules, regulations and contract language. (A.R.S. § 20-461 and A.A.C. R20-6-801)	8	X	
2	The time frame within which the company responds to complaints is in accordance with applicable statutes, rules and regulations. (A.R.S. § 20-461 and A.A.C. R20-6-801)	8	X	

Marketing and Sales

#	STANDARD	PAGE	PASS	FAIL
1	All advertising and sales materials are in compliance with applicable statutes, rules and regulations. (A.R.S. § 20-442)	8	X	

Producer Compliance

#	STANDARD	PAGE	PASS	FAIL
1	The producers are properly licensed in the jurisdiction where the application was taken. (A.R.S. §§ 20-282, 20-286, 20-287 and 20-311 through 311.03)	8	X	
2	An insurer shall not pay any commission, fee, or other valuable consideration to unlicensed producers. (A.R.S. § 20-298)	8	X	

Underwriting and Rating

#	STANDARD	PAGE	PASS	FAIL
1	The rates charged for the policy coverage are in accordance with filed rates (if applicable) or the Company Rating Plan. (A.R.S. §§ 20-341 through 20-385)	8	X	

#	STANDARD	PAGE	PASS	FAIL
2	Disclosures to insureds concerning rates and coverage are accurate and timely. (A.R.S. §§ 20-259.01, 20-262, 20-263, 20-264, 20-266, 20-267 and 20-2110)	8	X	
3	All forms and endorsements forming a part of the contract should be filed with the director (if applicable). (A.R.S. § 20-398)	8	X	
4	File documentation adequately supports decisions made. (A.R.S. § 20-385)	8	X	
5	Policies and endorsements are issued or renewed accurately, timely and completely. (A.R.S. §§ 20-1120, 20-1121 and 20-1654)	8	X	
6	Rescissions are not made for non-material misrepresentations. (A.R.S. §§ 20-463 and 20-1109)	8	X	
7	Authorization for Release of Information forms used for underwriting purposes contain required disclosures (A.R.S. § 20-2106)	8	X	

Cancellation and Non-Renewals

#	STANDARD	PAGE	PASS	FAIL
1	Declinations, Cancellations and Non-Renewals shall comply with state laws and company guidelines including the Summary of Rights to be given to the policyholder and shall not be unfairly discriminatory. (A.R.S. §§ 20-448, 20-2108, 20-2109 and 20-2110)	11	X	
2	Cancellations and Non-Renewal notices comply with state laws, company guidelines and policy provisions, including the amount of advance notice required and grace period provisions to the policyholder, nonrenewal based on condition of premises, and shall not be unfairly discriminatory. (A.R.S. §§ 20-191, 20-448, 20-1631, 20-1632, 20-1632.01, 20-1651 through 20-1656.	11		X

Claims Processing

#	STANDARD	PAGE	PASS	FAIL
1	The initial contact by the company with the claimant is within the required time frame. (A.R.S. § 20-461 and A.A.C. R20-6-801)	8	X	
2	Timely investigations are conducted. (A.R.S. § 20-461, and A.A.C. R20-6-801)	8	X	
3	The company claim forms are appropriate for the type of product and comply with statutes, rules and regulations. (A.R.S. §§ 20-461, 20-466.03, 20-2106, and A.A.C. R20-6-801)	8	X	
4	Claim files are adequately documented in order to be able to reconstruct the claim. (A.R.S. §§ 20-461, 20-463, 20-466.03 and A.A.C. R20-6-801)	8	X	
5	Claims are properly handled in accordance with policy provisions and applicable statutes, rules and regulations. (A.R.S. §§ 20-268, 20-461, 20-462 and A.A.C. R20-6-801)	8	X	
6	The company uses reservation of rights and excess of loss letters, when appropriate. (A.R.S. § 20-461 and A.A.C. R20-6-801)	8	X	
7	Deductible reimbursement to insureds upon subrogation recovery is made in a timely and accurate manner. (A.R.S. §§ 20-461, 20-462 and A.A.C. R20-6-801)	8	X	
8	The company responds to claim correspondence in a timely manner. (A.R.S. § 20-461, 20-462 and A.A.C. R20-6-801)	8	X	
9	Denied and closed without payment claims are handled in accordance with policy provisions and state law. (A.R.S. §§ 20-461, 20-462, 20-463, 20-466, 20-2110 and A.A.C. R20-6-801)	8	X	
10	No insurer shall fail to fully disclose to first party Insureds all pertinent benefits, coverages, or other provisions of an insurance policy or insurance contract under which a claim is presented. (A.A.C. R20-6-801)	8	X	
11	Adjusters used in the settlement of claims are properly licensed (A.R.S. §§ 20-321 through 20-321.02)	8	X	