



REPORT OF MARKET CONDUCT EXAMINATION

OF

STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY

NAIC CoCode 25178

AND

STATE FARM FIRE AND CASUALTY COMPANY

NAIC CoCode 25143

AS OF

July 31, 2021

AZ Exam No. 47123

NAIC MATS No. AZ-BORUNDAS-9

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Market Regulation and Consumer Services Division
Arizona Department of Insurance and Financial Institutions
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Douglas A. Ducey, Governor
Evan G. Daniels, Director

Director Evan G. Daniels
Arizona Department of Insurance and Financial Institutions
100 N. 15th Ave, Suite 261
Phoenix, Arizona 85007-2624

Dear Director Daniels:

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

State Farm Mutual Automobile Insurance Company, NAIC CoCode 25178
And
State Farm Fire and Casualty Company, NAIC CoCode 25143

Shelly Schuman, ACS, AIE, AMCM, CICSR, CIS, FLMI, HIA, PAHM, Market Conduct Examination Supervisor, conducted the examination with the assistance of Bruce Glaser, CIE, MCM, AIRC, CPCU, CLU, ChFC, FLMI, ARM-Pe, CICSR, CRIS, FAHM, Market Conduct Examiner-in-Charge, Tony Taylor, DM, MCM, Market Conduct Data Management Specialist, and George Kalargyros, MCM, LPCS, Market Conduct Insurance Examiner.

The examination covered January 1, 2015, through July 31, 2021.

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

Sincerely yours,

A handwritten signature in blue ink that reads "Maria G. Ailor".

Maria G. Ailor, AIE, AMCM, Assistant Director
Market Regulation and Consumer Services Division

AFFIDAVIT

STATE OF MISSOURI)
)
) ss.
COUNTY OF JACKSON)

Shelly Schuman, ACS, AIE, AMCM, CICSR, CIS, FLMI, HIA, PAHM, being first duly sworn, states that I am a duly appointed Market Conduct Examination Supervisor for the Arizona Department of Insurance and Financial Institutions. Under my direction and with my participation and the participation of Bruce Glaser, CIE, MCM, AIRC, CPCU, CLU, ChFC, FLMI, ARM-Pe, CICSR, CRIS, FAHM, Market Conduct Examiner-in-Charge, Tony Taylor, DM, MCM, Market Conduct Data Management Specialist, and George Kalargyros, MCM, LPCS, Market Conduct Insurance Examiner, the Examination of State Farm Mutual Automobile Insurance Company, and State Farm Fire and Casualty Company, hereinafter referred to as the "Companies," was performed at the request of the Arizona Department of Insurance and Financial Institutions. The information contained in this Report, which consists of the following pages, is true and correct to the best of my knowledge and belief, and 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.

Shelly Schuman

Shelly Schuman, ACS, AIE, AMCM, CICSR, CIS, FLMI, HIA, PAHM,
Market Conduct Examination Supervisor
INS Regulatory Insurance Services, Inc.

Subscribed and sworn to before me this 27 day of December, 2022.

Robbie Tubbs

Notary Public

My Commission Expires: March 10, 2023



ROBBIE L. TUBBS
My Commission Expires
March 10, 2023
Jackson County
Commission #15464082

FOREWORD

This market conduct examination report of State Farm Mutual Automobile Insurance Company and State Farm Fire and Casualty Company (herein referred to as the “Companies”) was prepared by employees of the Arizona Department of Insurance and Financial Institutions (Department) as well as independent examiners contracting with the Department. A market conduct examination reviews certain business practices of insurers licensed to conduct insurance business in Arizona. The examiners reviewed the Companies in accordance with Arizona Revised Statutes (A.R.S.) §§ 20-142, 20-156, and 20-157. 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 Private Passenger Automobile (PPA) and Homeowners (HO) business operations related to Underwriting and Rating.

Certain unacceptable or non-complying practices may not have been discovered during 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 Companies was conducted in accordance with the standards and procedures established by the National Association of Insurance Commissioners (NAIC) and the Department. The purpose of the examination was to determine the Companies' compliance with Arizona's insurance laws.

The focus of the examination was the Companies' compliance with A.R.S. § 20-2110(F)(3) and the use of bankruptcies as a rating factor. The Companies were requested to conduct a self-audit of its credit scoring models for all property and casualty products sold in Arizona for the period from January 1, 2015, to July 31, 2021. The purpose of the self-audit was to determine if consumers were rated and paid higher premiums as the result of a bankruptcy older than seven (7) years in violation of A.R.S. § 20-2110(F)(3). If violations were found as part of the self-audit, the Companies would be required to submit a Corrective Action Plan (CAP) to remediate those violations.

EXAMINATION REPORT SUMMARY

The examination concluded that the Companies' Rating function failed to comply with Arizona statutes and rules regarding A.R.S. § 20-2110(F)(3). Specifically, the Companies failed to demonstrate (i) a process to identify and track at inception the permissible use of adverse credit factors in calculating an insurance score, (ii) a process to identify at renewal whether a policy's bankruptcy record aged to more than seven (7) years, and (iii) the ability to disregard that information or re-rate the individual once the bankruptcy surpassed its allowable usage.

During the course of the examination, the Companies explained that credit information is ordered from their vendor on new business policies to help determine the Customer Rating Index (CRI) using the credit factor derived from the credit information. The credit factor, in which bankruptcies can play a role as allowed by law, is just one element of the overall CRI. However, bankruptcies are not used as a discrete and independent analysis element. A bankruptcy record is only one of a pool of potential public records that can play a part in the analysis. The credit information received from the Companies' vendor comes in the form of summarized attributes of the credit report. These summarized attributes are aggregated to serve as inputs to the insurance risk model. These inputs do not isolate bankruptcies individually but are grouped with other adverse public records. Consequently, the Companies failed to provide the date of bankruptcy for its policies to show compliance with A.R.S. § 20-2110(F)(3).

The CRI model score is refreshed by the Companies at every policy renewal, but the credit factor (which may include a bankruptcy) is not and is utilized for multiple years. For PPA, credit information is ordered at the time of new business, then at the two-year renewal, and then again every three (3) years thereafter while the policy remains unchanged and in force. For HO, a credit report is ordered at the time of new business and again every three (3) years thereafter while the policy remains unchanged and in force. Thus, a bankruptcy that was once six (6) years old could age to more than nine (9) years before being removed as a factor in calculating a consumer's premium. The Companies stated that there is no Knowledge-Based System (KBS) or other computer analysis in place to determine when to reorder credit as all policies automatically have credit reordered at two or three-year intervals. The Companies' assert that their PPA and HO policies are compliant with Arizona law because the prescribed seven-year time period "turns on the calculation of the credit factor" (which was conducted only every few years). However, the Department respectfully disagrees.

The Department's position is that A.R.S. § 20-2110(F)(3) prohibits the use of bankruptcies that are more than seven years old and this timeline begins on the date that the bankruptcy is adjudicated; this timeline cannot be extended unilaterally by a company's internal policy to rerun the credit factor at its discretion. This position is supported by the statute's language and its clear

intent to place explicit time limits on the use of adverse credit factors, such as a bankruptcy, both at policy inception and renewal. Put simply, the Department's position is that A.R.S § 20-2110(F) prohibits the use of specific bankruptcy information after statutorily prescribed timeframes.

CORRECTIVE ACTION PLAN

This Corrective Action Plan ("CAP") defines the corrective action requirements applicable to the Companies resulting from the market conduct examination conducted by the Department.

Area of Concern: Bankruptcy Factor Rating of Policies

Corrective Actions

- Action A: No later than April 1, 2023 the Companies will cease using bankruptcy information in the calculation of the credit factor for PPA and HO business.
- Action B: Prior to each upcoming policy renewal following the completion of Action A, for each policyholder affected by an adverse public record as defined in the Companies' credit factor calculation:
- i. Identify which policyholders have reached at least 84 months of age, or will reach 84 months of age prior to the next scheduled refresh of information;
 - ii. Refresh the credit information for the identified existing policyholder's insurance score; and
 - iii. Adjust their renewal rates and premiums accordingly.
- Action C: Upon credit recalculation at renewal (i.e. Action B) and, where it is identified that a policy was previously renewed and included an adverse public record as defined in the Companies' credit factor calculation which was more than 84 months of age at the time of use as a rating factor, issue a flat \$100 refund or premium credit to each applicable policyholder.

Follow Up Actions:

- (A) Propose a timeline for implementation of the new processes.
- (B) File applicable revisions to Company rate or rule filings.
- (C) Complete Action A by April 1, 2023.
- (D) Complete Actions B and C prior to each policy renewal for no less than 13 months after the implementation of Action A.
- (E) Provide monthly status updates in a form prescribed by the Department throughout implementation.

The following is a summary of the examiners' findings.

RATING

Homeowners, Condominium, and Manufactured Home (HO)

The examiners reviewed the initial data for HO new business and renewed policies active during the period under examination. There were 2,344,238 policies identified as in scope during the examination. The Companies failed to identify which policies were rated for having one or more bankruptcies at the inception date or subsequent renewal.

The following Underwriting and Rating Standards Failed:

#	Standard	Regulatory Authority
AZ	The insurer shall not use a bankruptcy or a lien satisfaction that is more than seven years old.	A.R.S. § 20-2110(F)(3)

Private Passenger Automobile (PPA)

The examiners reviewed the initial data for PPA new business and reinstated, reissued, and renewed policies active during the period under examination. There were 12,802,699 PPA policies identified as in scope during the examination. The Companies failed to identify which policies were rated for having one or more bankruptcies at the inception date or subsequent renewal.

The following Underwriting and Rating Standards Failed:

#	Standard	Regulatory Authority
AZ	The insurer shall not use a bankruptcy or a lien satisfaction that is more than seven years old.	A.R.S. § 20-2110(F)(3)

Preliminary Finding #1 – Bankruptcy Rating of Policies

The Companies allege that the Customer Rating Index (CRI) does not identify the date of bankruptcy. And because the Companies only recalculate the credit factor at two or three-year intervals, the Companies purportedly cannot identify which policies utilized a bankruptcy over seven (7) years old at subsequent renewals. The Companies use of bankruptcies over seven (7) years old adversely affects the premium for these policies and fails to comply with A.R.S. § 20-2110(F)(3).

Recommendation #1

The Companies implement the Corrective Action Plan (CAP) as detailed in the Examination Report Summary.