

**REPORT OF**  
**MARKET CONDUCT EXAMINATION**  
**OF**  
**GREAT AMERICAN E&S INSURANCE COMPANY**  
**AS OF**  
**AUGUST 29, 2005**

I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON MARKET CONDUCT EXAMINATION, made as of AUGUST 29, 2005 of the

**GREAT AMERICAN E&S INSURANCE COMPANY**

is a true and correct copy of the document filed with this Department.

ATTEST BY:

*Antoinette Handy*

DATE: 6 MARCH 2007

*In Witness Whereof,* I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 6TH DAY OF MARCH 2007.



*Matthew Denn*

*Insurance Commissioner*

**REPORT ON MARKET CONDUCT EXAMINATION**  
OF THE  
**GREAT AMERICAN E&S INSURANCE COMPANY**  
AS OF  
**AUGUST 29, 2005**

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Matt Denn", written over a horizontal line.

MATTHEW DENN  
INSURANCE COMMISSIONER

DATED this 6TH day of MARCH, 2007.

**Table of Contents**

SALUTATION ..... 1

SCOPE OF EXAMINATION..... 2

HISTORY AND PROFILE ..... 2

METHODOLOGY ..... 3

A. COMPANY OPERATIONS/MANAGEMENT..... 4

    Standard A7 ..... 4

    Standard A 09 ..... 4

B. COMPLAINTS/GRIEVANCES..... 5

REVIEW OF PROCEDURES ..... 5

    Procedure 01 – Audit (Internal and External)..... 5

    Procedure 03 – Company Records, Central Recovery and Backup..... 6

    Procedure 04 – Computer Security ..... 7

    Procedure 05 – Anti-Fraud..... 7

    Procedure 06 – Disaster Recovery ..... 8

    Procedure 07 – Managing General Agent (MGA) Oversight and Control ..... 8

    Procedure 08 – Vendor Oversight and Control..... 9

    Procedure 09 – Customer and Consumer Privacy Protection ..... 9

    Procedure 10 – Insurance Information Management ..... 9

    Procedure 11 – Complaint Handling..... 10

    Procedure 13 – Advertising, Sales and Marketing..... 10

    Procedure 14 – Agent Produced Advertising..... 11

    Procedure 20 – Producer Selection, Appointment and Termination ..... 11

    Procedure 21 – Producer Defalcation ..... 12

    Procedure 22 – Prevention of Use of Persons with Felony Conviction..... 13

    Procedure 25 – Correspondence Routing ..... 13

    Procedure 26 – Policy Issuance ..... 13

    Procedure 27 – Reinstatement ..... 14

    Procedure 28 – Insured or Member Requested Claim History ..... 14

    Procedure 30 – Premium Determination and Quotation..... 15

    Procedure 31 – Policyholder Disclosures ..... 15

    Procedure 32 – Underwriting and Selection ..... 16

    Procedure 34 – Termination..... 17

    Procedure 35 – Underwriting File Documentation ..... 18

    Procedure 36 – Underwriting Training ..... 18

    Procedure 40 – Staff Training..... 19

    Procedure 42 – Adjuster Training..... 19

    Procedure 43 – Claim Handling..... 20

    Procedure 44 – Internal Claim Audit ..... 20

    Procedure 45 – Claim File Documentation..... 20

    Procedure 46 – Subrogation and Deductible Reimbursement ..... 20

    Summary ..... 21

LIST OF RECOMMENDATIONS ..... 21

CONCLUSION..... 22

## **SALUTATION**

October 16, 2006

Honorable Matthew Denn  
Insurance Commissioner  
State of Delaware  
841 Silver Lake Boulevard  
Dover, Delaware 19904

Dear Commissioner Denn;

In compliance with the instructions contained in Certificate of Examination Authority Number 05.730, and pursuant to statutory provisions including 18 Del. C. §318-322, a market conduct examination has been conducted of the affairs and practices of:

### **Great American E & S Insurance Company**

hereinafter referred to as the "Company" or as "Great American." Great American E & S Insurance Company is incorporated under the laws of the State of Delaware. The on-site phase of the examination was conducted at the following location:

580 Walnut Street Cincinnati, OH 45202.

The examination is as of August 29, 2005.

Examination work was also completed off premises and at the offices of the Delaware Department of Insurance, hereinafter referred to as the "Department" or as "DDOI."

The report of examination thereon is respectfully submitted.

## **SCOPE OF EXAMINATION**

The basic business areas that are subject to a Delaware Market Conduct Examination vary depending on the type on insurer. For all insurers, these areas include:

- Company Operations/Management
- Complaint Handling
- Marketing and Sales
- Producer Licensing
- Policyholder Service
- Underwriting and Rating
- Claims

Each business area has standards that can be examined and measured, typically utilizing sampling methodologies.

This examination is a Delaware Baseline Market Conduct Examination. It is comprised of two components. The first is a review of the Company's countrywide complaint patterns. This is not a pass/fail test. It is aimed at determining if there is a detectable pattern to the complaints the Company receives from all sources.

The second component is an analysis of the management of the various business areas subject to a market conduct examination through a review of the written procedures of the Company. This includes an analysis of how the Company communicates its instructions and intentions to its lower echelons, how it measures and monitors the results of those communications, and how it reacts to and modifies its communications based on the resulting findings of the measurement and monitoring activities. The examiners also determine whether this process is dynamic and results in enhanced compliance activities. Because of the predictive value of this form of analysis, focus is then made on those areas where review indicators suggest that the process used by management does not appear to be achieving appropriate levels of statutory and regulatory compliance.

All business areas noted above are addressed to some extent by one or more of the procedures reviewed thus providing a comprehensive view of the Company and its component operations.

This examination report is a report by test rather than a report by exception. This means that all areas tested are described and the results indicated. Substantial departure from the norm may result in a supplemental review that focuses on the area so noted.

## **HISTORY AND PROFILE**

On February 28, 1979, the Company was incorporated in the state of Delaware under the name Agricultural Excess and Surplus Lines Company. The Company was formed as a wholly owned subsidiary of Great American Insurance Company for the purpose of conducting surplus lines business.

On June 15, 2000, the Company changed its name to Great American E & S Insurance Company.

## **METHODOLOGY**

This examination is based on the Standards and Tests for a Market Conduct Examination of a Property and Casualty Insurer found in Chapter VIII of the Delaware Market Conduct Examiners' Handbook. This chapter is derived from applicable Delaware statutes, rules, and regulations as referenced herein and the *NAIC's Market Conduct Examiners' Handbook*.

Some standards are measured using a single type of review, while others use a combination of all of the types of review. The types of review used in this examination fall into three general categories: "generic," "sample," and "electronic."

A "generic" review indicates that a standard was tested through an analysis of general data gathered by the examiner, or provided by the examinee in response to queries by the examiner.

A "sample" review indicates that a standard was tested through direct review of a random sample of files using sampling methodology described in the Delaware Market Conduct Examiners' Handbook and the *NAIC's Market Conduct Examiners' Handbook*. For statistical purposes, an error tolerance level of seven percent (7%) is used for claim reviews and a ten percent (10%) tolerance level is used for other types of review. The sampling techniques used are based on a ninety-five percent (95%) confidence level. This means that there is a 95% confidence level that the error percentages shown in the various standards so tested are representative of the entire set of records from which it was drawn. Note that the statistical error tolerance is not indicative of the DDOI's actual tolerance for deliberate error.

An "electronic" review indicates that a standard was tested through the use of a computer program or routine applied to a download of computer records of the examinee. This type of review typically looks at 100% of the records of a particular type.

Standards are measured using tests designed to adequately determine how the examinee met the standard. The various tests utilized are set forth in the Delaware Market Conduct Examiners' Handbook for a Property and Casualty Insurer. Each standard applied is described and the result of the testing is provided under the appropriate standard. The standard, its statutory authority under Delaware law, and its source in the *NAIC's Market Conduct Examiners' Handbook* are stated and contained within a bold border.

Each Standard is accompanied by a "Comment" describing the purpose or reason for the Standard. The "Result" is indicated and the examiners' "Observations" are noted. In some cases a "Recommendation" is made. Comments, Results, Observations and Recommendations are reported within the appropriate Standard.

## A. COMPANY OPERATIONS/MANAGEMENT

This examination report is not designed to be a pass/fail report with the exception of the following two standards which read:

- “The Company is licensed for the lines of business that are being written.”
- “The Company cooperates on a timely basis with examiners performing the examinations.”

### Standard A7

*NAIC Market Conduct Examiners' Handbook - Chapter XV §A, Standard 7 & Chapter XVII §A, Standard 7*

**The Company is licensed for the lines of business that are being written.**

18 Del. C. §318(a), §505(b), §508(b)

The review methodology for this standard is by “generic.” This standard has a direct insurance statutory requirement. This standard is intended to ensure that the Company’s operations are in conformance with the Company’s certificate of authority.

*Results: Pass*

*Observations:* The Company appears to be licensed for the lines of business being written based upon a review of premium schedules and the Company’s Delaware Certificate of Authority.

*Recommendations:* None

### Standard A 09

*NAIC Market Conduct Examiners' Handbook - Chapter VIII §A, Standard 9*

**The Company cooperates on a timely basis with examiners performing the examinations.**

18 Del. C. §318(a), §320(c), §508(b), §520(b)3

The review methodology for this standard is “generic.” This standard has a direct insurance statutory requirement. This standard is aimed at ensuring that the Company is cooperating with the state in the completion of an open and cogent review of the Company’s operations. Cooperation with the examiners in the conduct of an examination is not only required by statute, it is conducive to completing the examination in a timely fashion, thereby minimizing cost.

*Results: Pass*

*Observations:* During the course of the examination Great American was provided with fifty-one (51) Information Requests (IRs) and all responses were returned timely. The Company’s communication with the examiners was responsive. The examiners experienced no delays during the course of the examination.

*Recommendations:* None

## **B. COMPLAINTS/GRIEVANCES**

The evaluations of the Standards in this business area are based on the Company's response to various information requests (IR items) and the complaint files at the Company. Delaware statute 18 Del. C. §2304(17) requires the Company to "...maintain a complete record of all complaints received." The statute also requires that "this record shall indicate the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of these complaints and the time it took to process each complaint." Delaware's definition of a complaint is "... any written communication primarily expressing a grievance."

*Observations:* The Company provided a database with twenty eight (28) logged complaints for the period of examination. All complaints in the complaint log were reviewed to compare the accuracy of the database and to look for any complaint patterns. After the review was completed no complaint patterns were present in the master log. The review of the complaint process is noted in Procedure 11 below.

## **REVIEW OF PROCEDURES**

The management of well-run companies generally has some processes that are similar in structure. These processes generally take the form of written procedures. While these procedures vary in effectiveness from company to company, the absence of them or the ineffective application of them is often reflected in the failure of the various Standards that follow this section. The processes usually include:

- a planning function wherein direction, policy, objectives and goals are formulated;
- an execution or implementation of the planning function elements;
- a measurement function that considers the results of the planning and execution; and
- a reaction function that utilizes the results of measurement to take corrective action or to modify the process to develop more efficient and effective management of its operations.

The absence of written procedures that provide direction for company staff in its various operational areas tends to produce inconsistent application of the intended process. The same is generally true for the absence of a means to measure the results of the application of procedures and determine that the process is performing as intended.

The reviews in this section are not pass/fail measurements. Rather, they are intended to reflect those management strengths and weaknesses that have a bearing on regulatory compliance issues.

### **Procedure 01 – Audit (Internal and External)**

*Observations:* The Company has an Internal Audit Department that has the responsibility of auditing all entities contained within the Group. This Department is overseen by the Company's Audit Committees for both the parent group and the individual company. Both Audit

Committees receive quarterly written reports detailing the activities of the Internal Audit Department (IA).

Each audit that is conducted by IA has a written audit program to guide the process. The programs are customized for every audit based upon planning meetings held with the senior management of the entity as well as the Company's corporate level management or the Group's senior officers. IA coordinators also perform research regarding the financial and operating results of every entity considered for audit and will amend the audit programs where appropriate to accommodate specific conditions. The IA management determines the scope of the audit after considering input from either the Board of Directors or the Audit Committees.

The audits of the entities within the Group are selected annually based upon a risk assessment process. IA management meets with the Audit Committees to discuss the relative business risks of over ninety (90) possible entities and a rolling twelve (12) month audit plan is agreed upon. The relative priority is also assigned as to timing of scheduled audits. There is no specific frequency consideration used in the Company's process for determining audits, but rather a business risk approach is used.

Audits combine both operational and financial disciplines, as well as information technology auditing of the entity's computer systems. Scope restrictions have not been imposed on the work of IA. All audit reports contain recommendations and have management's direct response documented. There is a formal process for follow-up of audit recommendation implementation status.

All members of the IA department are required to attend training programs each year. These programs are either internally or externally sponsored, are chosen by the audit management and relate to each auditor's needs and experience level.

No conflicts with Delaware's statutes or regulations are noted.

*Recommendations:* None

### **Procedure 03 – Company Records, Central Recovery and Backup**

*Observations:* The Record Retention Program document is dated June 2005, and states that it supersedes previous procedures, notably one dated 2004. Based upon a review of the documents it appears that portions of this procedure have been added since the 2004 version. As such, it appears that the Company updates this document on a continual basis.

A portion of the Record Retention Manual is dedicated to the Company's Record Retention Schedule. The schedule includes a listing for policy files - which includes the application, declaration page, endorsements, and documentation produced during the underwriting and rating of a policy. These files are maintained for a period of ten (10) years following the termination of final activity on the file. This process was confirmed by the examiners using a review of documents that are used throughout this process.

*Recommendations:* None

## **Procedure 04 – Computer Security**

*Observations:* The Information Security policy is well written, clear and concise. The policy is separated into well-defined sections and is dated October 1, 1999. The policy is supplemented by the Record Retention Manual, which is dated June 2005. The procedure applies to all employees and covers all users of corporate, computer and telephonic systems that process, store or capture information used in the business activities of the Company.

Oversight and control on the Business Unit level starts with the Business Unit Head. This individual enforces compliance with the Information Security Policy and ensures that employees in their respective Business Units are provided with the necessary training and materials to understand the Company's security policy. The Business Unit Head is also responsible for "Responding in a timely and proactive manner to reports of events likely to cause security exposures." The Company also maintains an Information Security Department. This department is responsible for providing guidance in the application of security techniques. Measurement structures are built into the Company's systems.

*Recommendations:* None

## **Procedure 05 – Anti-Fraud**

*Observations:* The Company has several written procedures for Anti-Fraud. The example provided is clear and readable. The current procedure is dated September 2005. No conflicts with Delaware's statutes or regulations are noted.

The Company has an Investigative Services function that is responsible for internal investigations affecting the Group and its subsidiaries and affiliated companies. Investigative Services is responsible for protecting the Company against illegal acts by Company agents, employees or vendors. Investigative Services is also responsible for investigating reported acts of wrongdoing and examining the various units of the Company for any evidence of wrongdoing. Each case is retained in a comprehensive secure database housed at the administrative offices of the Group.

Investigative Services conducts a criminal conviction background check on each new employee of the Company. The Human Resources office of the Company begins the process by faxing a copy of the background request form to Investigative Services. A member of Investigative Services utilizes a designated vendor to run a check for criminal convictions. The results are provided to the Human Resources requestor. In the event that a conviction is indicated by the background check Investigative Services then obtains copies of the actual courthouse documents pertaining to the offense. The employee or prospective employee is then interviewed by Investigative Services in conjunction with Human Resources. If the investigative conclusion is that the employee or prospective employee is the same person indicated in the court records then the individual is either not hired or their employment is terminated.

The above procedure is repeated whenever Investigative Services conducts a Business Unit Security Review or Internal Audit conducts an audit of the business unit.

The results of all applicant screenings is maintained in a comprehensive secure database housed at the administrative offices of the Group.

The Company maintains an Anti-Fraud procedure example from one of the states within which it operates. This plan identifies the companies that adhere to this plan. The document discusses the Mission of the Unit and ways to resist internal as well as external fraud. Internally, systems that the Company has in place have controls that help provide accountability at all levels within the Company. Employees are reminded in the document that they are obligated to report any suspected internal fraud. To resist external fraud, the Company trains its employees to recognize and investigate suspicious claims. This is accomplished through the Special Investigation Unit. Should the investigation lead to the discovery of fraudulent activity the Company refers the allegation to the appropriate law enforcement agency.

*Recommendations:* None

### **Procedure 06 – Disaster Recovery**

*Observations:* The Company uses a template for each asset (asset meaning any functions, systems or files deemed necessary for the Company to continue operating efficiently) it tracks for disaster recovery. These templates are a uniform plan that gives “asset information” including the asset name, description, the ownership, business units, recovery point objective, recovery time objective, the recovery team and contact list, and other supporting materials. Vendor contacts and license information is also included in the asset recovery document. A recovery process and procedure information section is provided in each asset recovery document, as is a post recovery process and monitoring section. The most recent version is dated August 17, 2005. No conflicts with Delaware’s statutes or regulations are noted.

Recovery plans exist for assets including the mainframe network, mainframe network applications, online systems, workstations, billing systems, databases, the mainframe, administration systems, etc. The Company’s disaster recovery charter was last updated on September 27, 2004.

A Mainframe test was conducted in July of 2005 in which no errors or areas of concern were noted. The Disaster Recovery (DR) Testing Manual provides a procedure for creating the Asset Recovery Plans. Methods for analyzing test results and deciding a strategy are also provided in the manual for DR Testing.

*Recommendations:* None

### **Procedure 07 – Managing General Agent (MGA) Oversight and Control**

*Observations:* The Company does not use Managing General Agents therefore this procedure is not applicable.

*Recommendations:* None

### **Procedure 08 – Vendor Oversight and Control**

*Observations:* The Company uses agreement forms for its Vendor Oversight and Control procedure that are developed by its Legal Department. The Company's Corporate Legal Department works with enterprise procurement and the various business units to monitor the agreements and to address any legal questions on an ongoing basis. The forms include a Work for Hire Agreement, Consulting Services Master Agreement, Confidential Information Agreement, and Access Agreement form. No conflicts with Delaware's statutes or regulations are noted.

*Recommendations:* None

### **Procedure 09 – Customer and Consumer Privacy Protection**

*Observations:* The Company has a written procedure for Customer and Consumer Privacy Protection. The version date of this document is unknown. Along with this procedure, the Company provides supplementary updates on relevant changes in state or federal law pertaining to privacy, including HIPAA, California Privacy Initiatives, and the Patriot Act. The most recent of these documents was dated September 18, 2003. The procedure is updated on an ongoing basis and as needed. No conflicts with Delaware's statutes and regulations are noted.

The Company's privacy handbook provides an overview of the importance of privacy in the "Information Age" as it outlines the five elements that the Company deems important in privacy overall. These elements are: privacy, security, accuracy, efficiency, and consistency. The Company developed the handbook in conjunction with the U.S. Federal Trade Commission's Fair Information Practices. The Company also provides its "Do's and Don'ts of Privacy" for its employees in this handbook. This is the Company's list of what every employee needs to know about privacy including a privacy checklist for the Company's employees. Regulatory requirements and guidelines for the Fair Credit Reporting Act, the Gramm-Leach-Bliley Act, HIPAA, the Right to Financial Privacy Act, US Unique State privacy Laws, and Non-US Privacy Laws are also addressed.

Privacy compliance resources are provided including web resources and Company contacts for privacy related questions.

*Recommendations:* None

### **Procedure 10 – Insurance Information Management**

*Observations:* The Company has a written Insurance Information Management procedure. This procedure relates to Procedure 9 (Customer and Consumer Privacy Protection Procedure), Procedure 4 (Computer Security Procedure) and Procedure 3 (Company Records, Central Recovery and Backup Procedure), and is addressed under each of those procedures.

*Recommendations:* None

### **Procedure 11 – Complaint Handling**

*Observations:* The most recent version of the Company's Customer Service Handling Guidelines is dated September 1, 2005. The Guidelines contain the following steps for an employee to follow: 1) Customer Service Inquiry Referral Form – this form is used by Corporate Legal to transmit all customer service inquiries received; 2) Customer Service Inquiry Data Sheet – used to document the details of the inquiry and its resolution; 3) Guidelines for Responding to Customers; and, 4) Guidelines for responding to insurance departments. These guidelines provide timeliness standards for employees to follow when responding to both insurance department and consumer complaints.

The Company maintains a company-wide Customer Service Inquiry Report. The report documents the number of complaints opened, geographic distribution and current status of the complaints and their resolution. This report provides management with an overview of current complaints.

*Recommendations:* None

### **Procedure 13 – Advertising, Sales and Marketing**

*Observations:* The Company has a written procedure for Advertising, Sales and Marketing that is clear and readable. The procedure was last updated in October of 2001, and was circulated March 22, 2002. No conflicts with Delaware's statutes and regulations are noted.

The Company does not expect its advertising procedures to change frequently, but would expect to issue updates approximately every three to four years. The procedures are continually reviewed as the Company conducts advertising reviews on a weekly basis. The guidelines are frequently referenced during these reviews.

The Company's advertising review procedures consist of the following: a legal review of advertising/marketing materials, an advertising project review form, a legal review for advertisements prepared in house, a legal review for advertisements prepared by an outside agency, and a service mark search.

The Company's manual provides detailed instructions for selecting, protecting, and using service marks. The manual also addresses the correct placement of service mark symbols and notices. The same attention is paid for copyright notices and work for hire agreements. The Advertising Content Guidelines address issues such as the avoidance of misleading language, use of testimonials, use of disclaimers, reprinting, notice of the prohibition of advertising for surplus lines, use of footnotes, and the retention of materials.

The Company's products are marketed to the Company's brokers who may then present materials to the insured at the insured's request. The Company does not accept business directly from an applicant. As such, the Company's marketing focus is on brokers specializing in professional liability insurance products.

*Recommendations:* None

#### **Procedure 14 – Agent Produced Advertising**

*Observations:* The Company does not authorize brokers to produce advertising materials.

*Recommendations:* None

#### **Procedure 15 – Producer Training**

*Observations:* The Company does not provide training to its brokers. It does require all brokers to be licensed and appointed. The Company's products are purchased by the insured through brokers and agents.

*Recommendations:* None

#### **Procedure 20 – Producer Selection, Appointment and Termination**

*Observations:* The Company has various forms it uses for the appointment and selection of its producers. A written process for the selection, appointment and termination of producers was provided to the examiners for review. The version date is unknown. No conflicts with Delaware's statutes or regulations are noted.

New producers seeking to place business with the Group contact the Company by telephone, facsimile, mail or e-mail. They are directed to the Senior Vice President of Underwriting for initial screening.

The initial screening process usually involves a telephone conversation where the Company determines whether the producer is interested in a particular line of business (e.g., property, casualty or both) and whether the producer is seeking binding authority or simply looking for a brokerage appointment.

If the prospective producer passes through initial screening they are required to complete a multi-page Producer Application. The Company also requests copies of their most recent financial statements, copies of the declarations page of the E&O insurance, and copies of valid surplus lines licenses

Completed applications and all attachments are reviewed by the President of the Group, Senior Vice President of Underwriting and the Vice President of any department likely to write the business of that producer as determined during the initial screening process. Approvals are specific to a particular department thus any producer may be granted the authority to deal with one department or all four (4) departments. Once the President, Senior Vice President of Underwriting and at least one departmental Vice President agree that the appointment is justified, a draft Producer Agreement is created and sent to the producer for signing.

Once signed copies of the Producer Agreements are received, a formal producer file is established and a number is assigned.

Periodically the Company will conduct reviews of its producer plant to ensure that the quantity and quality of activity warrants continuation. The Company's standard Producer Agreement allows either party to cancel the appointment by written notice.

*Recommendations:* None

### **Procedure 21 – Producer Defalcation**

*Observations:* The Company has a written procedure for Producer Defalcation comprised of a document that includes letters to the producers for the payment of the producers' account. The version date of this procedure is unknown. No conflicts with Delaware's statutes or regulations are noted.

Each month the Company sends the producer a statement of business processed by the Company for the producer's account. The Company requires its producers to remit their payment within forty-five (45) days, as specified in the Broker Agreement. Any producer who has not paid his or her account in full will be suspended for ten (10) days. In the event that a second offense occurs, the Company applies a thirty (30) day suspension. The suspensions will not be lifted despite subsequent payment of the account. If a producer is suspended for two consecutive months he or she will be terminated.

The producer's balances are monitored and managed at several different levels within the Company. The Accounting Collection Representatives are responsible for the collections of an assigned book of producers. The Accounting Representative will follow-up on unpaid items and solicit the Business Unit Underwriters to assist with the collections. The Accounting Collection Representatives report to a Supervisor or Manager, who is responsible for the collections of several lines of business. The Supervisor and Manager monitor the books of their representatives and become involved with collections when necessary.

The Business Units work with Specialty Accounting Services to collect outstanding premium or help address problems with respective producers. If a producer becomes delinquent Accounting will suspend the Producer under the terms of the Producer contract until the issue can be investigated and resolved. If agents are slow in paying, the agent may be changed to a Direct Bill only agent depending on the circumstances surrounding the delinquency.

If it is determined that fraud, such as misappropriation of funds or the producer is "out of trust" has occurred, Accounting refers these cases to the Internal Security department that investigates potential frauds, assists with collection efforts, and reports findings to the respective Department of Insurance.

Premium that the Company cannot collect through these measures are referred to the Legal Collections team in Specialty Accounting Services. This unit attempts to collect the outstanding balance internally before referring to the issue to a Collection Agency and/or an attorney.

*Recommendations:* None

## **Procedure 22 – Prevention of Use of Persons with Felony Conviction**

*Observations:* The Company's Investigative Services conducts a criminal conviction background check on each new employee of the organization. Please refer above to Procedure 5 - Anti-Fraud for more information. No conflicts with Delaware's statutes or regulations are noted.

Recommendations: None

## **Procedure 25 – Correspondence Routing**

*Observations:* The Company has procedures in place for Correspondence Routing. The procedures are clear and no conflicts with Delaware's statutes or regulations are noted.

The Company follows procedures that come directly from Great American Insurance Company. These procedures were reviewed and confirmed by the examiners during a tour of the Company's Home Office mailroom.

*Recommendations:* None

## **Procedure 26 – Policy Issuance**

*Observations:* The Company has a written Policy Issuance procedure. The procedure is clear and current. No conflicts with Delaware's statutes or regulations are noted.

The Company's producers are responsible for issuing all policies written under his or her contract's binding authority. Binding producers who issue their own policies are paid a higher commission rate as compensation. The Company provides the producer with "Formmaker" software (licensed by DocuCorp) to aid in policy preparation. The Underwriting Guide and its attachments describe the forms and endorsements that are required for a particular type of risk. The producer is required to forward to the Company a copy of each policy issued within thirty (30) days of the effective date either electronically or by U.S. mail. Failure to provide copies of policies within thirty (30) days can be grounds for contract termination.

Business written outside the contract's binding authority includes business classified as Casualty Binding Referral (CBR) or as a Middle Market Account (MMA). CBR and MMA may be issued either by the producer or by the company.

CBR business is business written by binding authority producers that require special submission and acceptance by a Company underwriter prior to binding either due to class of business, size or loss history. In almost all cases the producer, in accordance with the terms and conditions quoted by the Company underwriter using the "Formmaker" software, issues CBR policies. Receipt of a copy of the policy is required within thirty (30) days of the effective date. The policies are checked for completeness and accuracy when received. In relatively rare instances the CBR underwriter may choose to have the Company issue the policy.

MMA policies can be written for producers who may not have contract binding authority. In cases where the producer does not have binding authority the Company must issue the policy. In

cases where the producer is a binding producer, the Company's MMA underwriter determines whether the producer or the Company will issue the policy.

The Company issues all Casualty Special Risk Brokerage policies and Excess Casualty policies. Shortly after a risk is bound, the underwriter responsible prepares a draft version of the declarations page and a schedule of all endorsements to be attached. Draft policies are sent to a Company processor who creates the actual policies. The processor will also complete a coding sheet that will be forwarded for input into the system. Once completed the finished policies are returned to the underwriter for approval and sign off. After final approval by the underwriter the original policy plus three (3) copies are mailed to the producer.

Property Brokerage policies are usually issued by the Company, however, in some instances the Vice President will agree to let the producer issue the policy. Only those producers who have demonstrated the ability to correctly issue policies are permitted to do so. If the broker issues the policy the Company is to receive a copy within thirty (30) days of the effective date. In most of the cases where the Company issues the policies the process is the same as the one described above for CSRB and Excess Casualty.

*Recommendations:* None

#### **Procedure 27 – Reinstatement**

*Observations:* The Company has a written, current Reinstatement procedure. No conflicts with Delaware's statutes and regulations are noted. The Company will reinstate policies pending cancellation for non-payment of premiums if payment is received by the finance company on or before the cancellation date. If payment is received by the finance company no later than ten (10) days after the effective date of cancellation, the Company may reinstate the policy subject to the approval of the Departmental Manager. Approval is routinely granted. If payment is received by the finance company more than ten (10) days after the effective date of cancellation reinstatement is usually not granted.

The underwriter is authorized to reinstate policies pending cancellation if evidence that the original reason for the cancellation has been remedied on or before the cancellation date. The Departmental Manager may agree to reinstate a cancelled policy if evidence has been provided that the original reason for the cancellation was not correct. The reason for the cancellation must also have occurred prior to the cancellation date.

*Recommendations:* None

#### **Procedure 28 – Insured or Member Requested Claim History**

*Observations:* The Company has a written Insured or Member Requested Claim History procedure. The procedure is clear and current. No conflicts with Delaware's statutes or regulations are noted.

When the Insured requests copies of their claim histories their inquiries are directed to the appropriate underwriting department. The Company will only release copies of loss runs either

directly to the named Insured, the broker of record or a third party that has written authorization from the named Insured.

Once it has been determined that the Company has a proper request for loss runs either the underwriter responsible for the file or their assistant will retrieve the loss experience from the system and print a copy of the report. The report is faxed, e-mailed or mailed to the requesting party. In almost every case the loss runs are sent out within forty-eight (48) hours of receipt of the request. The procedure sets forth that in no event should it ever take longer than five (5) business days to process requests for loss runs.

Claim histories for the Company's insureds and their designated representatives are to be handled promptly and also with proper safeguards to protect the insured's privacy as dictated by the Great American Group's corporate privacy policy.

*Recommendations:* None

### **Procedure 30 – Premium Determination and Quotation**

*Observations:* The Company has a written Premium Determination and Quotation procedure. The procedure is clear and current. No conflicts with Delaware's statutes or regulations are noted.

The Company's business written under contract binding authorities is rated, for the most part, by applying the most current ISO loss costs for the appropriate classification to a loss cost multiplier prescribed by the Company's management. The Company periodically reviews the adequacy of their loss cost multiplier as they evaluate their underwriting results and general market conditions. The Company can adjust its loss cost multiplier if needed. They do not allow for any experience or schedule credits.

All business other than business written under the terms of a contract binding authority is referred to as brokerage business. All premiums for brokerage business are determined by the Company's underwriter on a risk-by-risk basis, subject to review by underwriting senior management.

The Company operates solely on a non-admitted basis and as such is not subject to any rate filing requirements. The only exception is that the Company has made a rate filing for Nursing Home General and Professional Liability risks located in Delaware.

*Recommendations:* None

### **Procedure 31 – Policyholder Disclosures**

*Observations:* The Company has a written Policyholder Disclosures procedure. The procedure is clear and current. No conflicts with Delaware's statutes or regulations are noted.

In some cases the Company stamps or endorses the policy to alert the policyholder to the fact that the insurance is written by a company not subject to licensing by the state. This notification also informs the policyholder that due to the non-admitted status of the issuing company their interest may not be protected by whatever state guaranty fund might otherwise apply. The responsibility to affix such stamps or endorsements is usually delegated to the surplus lines broker who is also responsible for collecting any surplus lines taxes owed.

Attached to every policy issued is a notice required by federal law that advises the Company's producers and the policyholder that the Company is prohibited from making payments to anyone on the SDN list or those otherwise subject to U.S. Economic Sanction Laws.

The Company also attaches another notice to every policy that advises their producer and policyholder that the policy was underwritten and priced based upon information and data provided to the Company by a licensed representative for the Insured.

Under the terms of the Terrorism Risk Insurance Act (TRIA) the Company is required to include with any quote issued notification of the availability of coverage for claims that might arise from certified acts of terrorism. Under the terms of TRIA the Company is obliged to offer such coverage and to separately display the premium charged for this coverage. In compliance with the Act, the Company obtains evidence of the named insured's acceptance or declination of the coverage. The appropriate endorsement is then attached to the policy and it is the Insured's decision to accept or reject coverage under the Act.

*Recommendations:* None

### **Procedure 32 – Underwriting and Selection**

*Observations:* The Company has a written Underwriting and Selection procedure. The procedure is clear and current. No conflicts with Delaware's statutes or regulations are noted.

The Company delegates the underwriting and selection process on business written under contract binding authorities to the binding authority producer. The Underwriting Guide outlines the parameters of the authority and provides a comprehensive set of rules that allows the producer to determine whether a specific risk is eligible or not. The Guide itself is based upon the ISO Classification Table and each individual classification is designated as acceptable, submit or decline. Many classifications include additional notes where specific situations or characteristics are addressed. The producer can, without the Company's advance consent, write classifications indicated as acceptable provided the application meets the other criteria outlined in the Guide. Other determinants of acceptability include risk size and claim experience. Risks over a certain size or risks that have experienced claims within the past three (3) years must be referred to a Company underwriter prior to acceptance. The binding authority is designed to target exposures that are small and simple.

Risks that do not qualify for acceptance under the contract authority may be submitted to the Company. These risks are treated as brokerage business.

The Company requires the binding producer to provide a copy of the policy within thirty (30) days of inception as well as a copy of the original application. They may also require loss runs and inspections on certain classes. Incoming policies and applications are reviewed by a Company underwriter for possible misclassification and to ensure that the policy is properly rated and issued. Violations of authority rules are handled individually and may result in corrective action including cancellation of the policy.

The Company's underwriters select all brokerage risks. Individual underwriters are granted specific underwriting authority. Either the Vice President responsible for that department, the Senior Underwriting Officer or the President of the Company, must approve certain classes of business, as well as all risks over a certain premium size.

All of the Company's underwriting departments are routinely subject to audit and review by others such as reinsurers, GAIC internal audit and GAIC outside auditors.

*Recommendations:* None

### **Procedure 34 – Termination**

*Observations:* No termination procedure was provided, however, the Company does have a written cancellation procedure which was provided to the examiners for review. The Cancellation procedure is clear written and is current. No conflicts with Delaware's statutes or regulations are noted.

The Company's Cancellation procedure requires the return of the original policy and the policy must include the Company's name, the policy number, effective date of cancellation, insured's signature, and if no reason for a cancellation is given, it is processed either as a short rate cancellation (S/R) or minimum earned premium (MEP), whichever results in a smaller return of premium. The notice of the cancellation must include the policy number, effective date of cancellation, the date the notice was sent, the Company's name, the insured's name and mailing address, and the reason for the cancellation must be as specific as possible.

If the insured is requesting a cancellation of their policy they must include the cancellation effective date, the notice must be signed by the insured, and the notice should identify the policy number, the insured's location, or type of coverage.

There are three (3) ways to cancel a policy: a flat cancellation in which the Policy is cancelled as of the inception date and has been approved by the underwriter; a short rate cancellation that is by the Insured's Request; and a pro rata cancellation which is because of Non-payment (short rate is allowed if the broker so elects), Company request, Insured's out of business, property sold, or rewritten through the Company.

*Recommendations:* None

### **Procedure 35 – Underwriting File Documentation**

*Observations:* The Company has a written Underwriting File Documentation procedure. The procedure is clear and current. No conflicts with Delaware’s statutes or regulations are noted.

The Company identifies files by the Company designed policy numbering system. The organization of any department’s policy files is to be determined by the Vice President in charge of that department.

Each underwriting file contains the following elements: a copy of the policy, a completed application along with any cover letter provided by the producer, any supporting materials provided by the producer for illustrative purposes, copies of loss runs or claim summaries, copies of all correspondence and underwriting notes, pricing notes (if applicable), coding sheets, and any other documents deemed appropriate by the handling underwriter.

Underwriting files for policies written under contract binding authorities include: a copy of the policy that was issued by the producer, a completed Accord application, at least three (3) years currently valued loss runs unless the Accord application is affirmatively checked that there have been no losses, and a copy of the inspection report if required by the Underwriting Guide.

All underwriting departments are routinely subject to audit and review by others such as reinsurers, GAIC internal audit and GAIC outside auditors. As part of the Company’s quarterly Sarbanes-Oxley sign offs the Company is required to review each department’s narrative to assess whether controls and procedures are in place and effective.

*Recommendations:* None

### **Procedure 36 – Underwriting Training**

*Observations:* The Company has a written Underwriting Training procedure. The procedure is clear and current. No conflicts with Delaware’s statutes or regulations are noted.

The training of a new underwriter is the responsibility of the Vice President of the department. Hiring of new personnel is made with oversight and participation of the Senior Vice President of Underwriting. The training includes “on the job” training, where the new hire shadows the VP and engages in the routine of daily job responsibilities. Job skills, concepts and procedures are introduced and explained. During the training sessions the VP monitors not only skills and knowledge but also the trainee’s ability to make decisions based on sound judgment. When the VP deems it appropriate, oversight of the new hire is transferred to a senior underwriter or manager and the new employee is formally integrated into the department.

The Company routinely sponsors a variety of training programs that are available to their staff. These programs address a wide range of issues including, developing supervisory and management skills, personal and career development, as well as general training for new technologies and office management products. New underwriters are expected to attend training programs the Company deems appropriate whether the programs are offered by the Company or by National Association of Professional Surplus Lines Offices (NAPSLO). The Company also

encourages participation in industry sponsored education programs such as CPCU and INS. The training is not mandatory and no consequences result from one not undergoing the training.

In recent years the Company has sent several people to a week long Surplus Lines School sponsored by NAPSLO. These schools are geared towards addressing underwriting and marketing issues specific to the E&S market. In addition, the Company's reinsurance treaty broker has invited several underwriters to attend training seminars at their home office that for the most part address reinsurance issues and catastrophe modeling.

*Recommendations:* None

#### **Procedure 40 – Staff Training**

*Observations:* The Company does not have a formal Staff Training procedure. Due to the Company's small staff and unique lines of business all training is conducted on a "one on one" basis between the employee and the responsible claim officer or manager. The annual employee performance appraisal documents the employee's progress based upon pre-established objectives and goals for the planning period.

The Company offers a broad spectrum of self-study courses along with CPCU, IIA, AIC, DRI and other industry related designations. All employees are eligible to participate in Company-sponsored programs. The Company provides an expense reimbursement plan for Company approved courses. The participants must be full time employees with more than six months of full time employment.

*Recommendations:* None

#### **Procedure 42 – Adjuster Training**

*Observations:* The Company provides training to all of its adjusters. There are various specific substantive areas that may be important for a business unit and for which that unit will train their adjusters via seminars and in-house meetings and training sessions.

The Staff Claims Office provides numerous classes and training seminars for all business units. These include Fair Claims Handling overview for various states, SIU training on fraud, as well as the annual line of business 3 day session for all claim adjusters covering topics such as e-discovery, the new claims system and processing and other topical subjects. Law firms also provide training sessions on relevant points of law during the year. Periodic audits of all claims operations are also performed and the outcomes are discussion pieces for education and training opportunities.

All new employees go through a corporate orientation and the "GAI University" offers a catalog of training and development courses as well.

*Recommendations:* None

### **Procedure 43 – Claim Handling**

*Observations:* The Company has a written Claim Handling procedure. The procedure is clear and current and was last revised in August 2005. No conflicts with Delaware's statutes or regulations are noted.

A claim is initiated when the Company receives a "loss notice" which is typically provided via facsimile or mail by a broker. A claims clerk receives the loss notice, records the claim on a claim registry (which is a hardcopy sheet listing the basic claim information), manually assigns a claim number, pulls the policy file, checks the policy file for any duplicate claims and prepares a claim file. The new loss is forwarded to a Senior Vice President who assigns it to a claim unit officer. The unit officer reviews the claim and prepares a new claim assignment form and forwards the form and the file to the appropriate file handler. File handlers maintain their files in a diary system. The claims officer reviews the diaries on a daily basis to monitor the claim status thus ensuring proper and timely claims handling. Initial reserves are set up within thirty (30) to sixty (60) days. If litigated, or if the Company needs to initiate settlement negotiations, attorneys are contacted.

The Company's Senior Vice President automatically reviews payments or reserve changes exceeding \$50,000.

*Recommendations:* None

### **Procedure 44 – Internal Claim Audit**

*Observations:* See Procedure 43 – Claim Handling

*Recommendations:* None

### **Procedure 45 – Claim File Documentation**

*Observations:* See Procedure 43 – Claim Handling

*Recommendations:* None

### **Procedure 46 – Subrogation and Deductible Reimbursement**

*Observations:* The Company has a written Subrogation and Deductible Reimbursement procedure. The procedure is clear and current and was last revised in August 2005. No conflicts with Delaware's statutes or regulations are noted.

Most of the Company's general liability policies contain a deductible. The deductibles range from \$250 to \$25,000. Claim Technicians for the Company have the responsibility of tracking and collecting deductibles. The Claim Technicians report to the Vice President of Claims.

The recovery procedure is as follows: deductible codes are entered into the system when a claim reserve is established. A report is generated by the system to identify files with outstanding

deductibles. This report is distributed monthly to the Claim Technician and Vice President. The Claim Technician is responsible for reviewing the report along with the individual claim file to identify deductibles requiring billing to the insured. Billings are issued by the Claim Technician to identify the insured. The billing notice includes copies of the policy declaration page, deductible endorsement, invoices, release and copies of checks verifying payment of loss and/or expenses. After the initial billing, the Claim Technician places the file in their diary for follow-up within thirty (30) days. Recovery checks are processed by the Claim Technician. If no recovery is received within thirty (30) days of the initial billing, a second billing is issued and the file re-stored for an additional thirty (30) days. This process is completed at thirty (30) day intervals for four (4) months. If no recovery is received within 120 days the file is referred to Johnson & Rountree, a collection agency, for collection. The recovery code is then changed and the file is stored for ninety (90) day intervals for follow-up by the Claim Technician. Once collection of the deductible is completed the file jacket is noted and the Claim Technician removes the file from their diary.

The Claim Technician completes a monthly report for management regarding recovery activity. The report covers current year recovery and the two prior year's recovery activity. The Claim Technician utilizes the report to summarize the collection recovery activities. The report includes Company results (incurred and recovered) for AEIC (American Empire Insurance Company), AESLIC (American Empire Surplus Lines Insurance Company), and FESIC (Fidelity Excess and Surplus Insurance Company); deductible coding changes (incurred and recovered); Current Recovery Totals (incurred and recovered); Remaining Amount Outstanding and the Current Recovery Percentage. Reports are submitted to the Claim Senior Vice President for reporting to Senior Management.

Internally generated reports allow the Company to check issues regarding reserve adequacy, reserve changes, adjuster caseloads, and deductible recovery percentages on a monthly basis. Any patterns of significant change are monitored and reviewed to determine if any changes in the procedures is warranted.

*Recommendations:* None

## **Summary**

The examination was a limited scope market conduct examination of the following business areas: Company Operations/Management, Complaint Handling, Marketing and Sales, Producer Licensing, Policyholder Service, Underwriting and Rating, and Claims.

## **LIST OF RECOMMENDATIONS**

Recommendations have been made to address the areas of concern noted during the examination. These are summarized below.

**There are no recommendations listed for the Company**

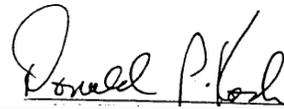
**CONCLUSION**

The examination was conducted by Donald P. Koch, Brian T. Tinsley, Susanna Stevens, Cindy Amann and Nobu Koch and is respectfully submitted.



---

Brian Tinsley, AIE  
Market Conduct Examiner-in-Charge  
Insurance Department  
State of Delaware



---

Donald P. Koch, CIE  
Market Conduct Supervising Examiner  
Insurance Department  
State of Delaware