[IN ACCORDANCE WITH CALIFORNIA INSURANCE CODE (CIC) SECTION 12938, THIS REPORT WILL BE MADE PUBLIC AND PUBLISHED ON THE CALIFORNIA DEPARTMENT OF INSURANCE (CDI) WEBSITE]

PUBLIC REPORT OF THE TARGETED MARKET CONDUCT EXAMINATION OF

EMPIRE FIRE AND MARINE INSURANCE COMPANY
NAIC #21326 CDI #2502-3

FIDELITY AND DEPOSIT COMPANY OF MARYLAND
NAIC #39306 CDI #2479-4

ZURICH AMERICAN INSURANCE COMPANY
NAIC #16535 CDI #4581-5

UNIVERSAL UNDERWRITERS INSURANCE COMPANY
NAIC #41181 CDI #2854-8

AMERICAN ZURICH INSURANCE COMPANY
NAIC #40142 CDI #2931-4

AMERICAN GUARANTEE AND LIABILITY INSURANCE COMPANY
NAIC #26247 CDI #1237-7

AND ITS PRACTICES AND PROCEDURES RELATING TO DEPRECIATION IN PROPERTY INSURANCE CLAIMS

AS OF MAY 31, 2014

ADOPTED DECEMBER 16, 2015

STATE OF CALIFORNIA

CALIFORNIA DEPARTMENT OF INSURANCE

MARKET CONDUCT DIVISION

FIELD CLAIMS BUREAU

NOTICE

<u>The provisions of Section 735.5(a) (b) and (c) of the California Insurance Code (CIC) describe the Commissioner's authority and exercise of discretion in the use and/or publication of any final or preliminary examination report or other associated documents. The following examination report is a report that is made public pursuant to California Insurance Code Section 12938(b)(1) which requires the publication of every adopted report on an examination of unfair or deceptive practices in the business of insurance as defined in Section 790.03 that is adopted as filed, or as modified or corrected, by the Commissioner pursuant to Section 734.1.</u>

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STATE OF CALIFORNIA Dave Jones, *Insurance Commissioner*

DEPARTMENT OF INSURANCE
Consumer Services and Market Conduct Branch
Field Claims Bureau, 11th Floor
300 South Spring Street
Los Angeles, CA 90013

December 16, 2015

The Honorable Dave Jones
Insurance Commissioner
State of California
300 Capitol Mall
Sacramento, California 95814

Honorable Commissioner:

Pursuant to instructions, and under 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, a targeted examination was made of the claims handling practices and procedures in California of:

EMPIRE FIRE AND MARINE INSURANCE COMPANY
NAIC #21326
FIDELITY AND DEPOSIT COMPANY OF MARYLAND
NAIC #39306
ZURICH AMERICAN INSURANCE COMPANY
NAIC #16535
UNIVERSAL UNDERWRITERS INSURANCE COMPANY
NAIC #41181
AMERICAN ZURICH INSURANCE COMPANY
NAIC #40142
AMERICAN GUARANTEE AND LIABILITY INSURANCE COMPANY
NAIC #26247

Group NAIC #0212

Hereinafter, the Companies listed above also will be referred to as EFMIC, FDCM, ZAIC, UUIC, AZIC, AGLIC, the Company or, collectively, as the Companies.

This report is made available for public inspection and is published on the California Department of Insurance website (www.insurance.ca.gov) pursuant to California Insurance Code section 12938(b)(1).

FOREWORD

The targeted examination sought to identify whether the aforementioned Companies' handling of first-party Homeowners' Property (Homeowner) and Commercial Property insurance claims complied with the provisions of California Insurance Code (CIC) §§2051 and 2051.5, and California Code of Regulations (CCR) §2695.9(f) pertaining to depreciation. Specifically, the examination focused on whether the Companies documented and considered the actual condition of each item when making an assessment regarding the amount of depreciation to be deducted. The claims reviewed were closed during the period of June 1, 2013 through May 31, 2014. The examination did not include an evaluation of how the Companies determine the depreciation percentage per year or an evaluation of how the Companies determine the useful life of structural components and personal property.

The report is written in a "report by exception" format. The report does not present a comprehensive overview of the subject insurer's practices. The report contains a summary of pertinent information about the lines of business examined, details of the non-compliant or problematic activities that were discovered during the course of the examination and the insurer's proposals for correcting the deficiencies. When a violation that reflects an underpayment to the claimant is discovered and the insurer corrects the underpayment, the additional amount paid is identified as a recovery in this report. While this report contains alleged violations of law that were cited by the examiner, additional violations of CIC §790.03, or other laws, not cited in this report may also apply to any or all of the non-compliant or problematic activities that are described herein.

All unacceptable or non-compliant activities may not have been discovered. Failure to identify, comment upon or criticize non-compliant practices in this state or other jurisdictions does not constitute acceptance of such practices.

Alleged violations identified in this report, any criticisms of practices and the Companies' responses, if any, have not undergone a formal administrative or judicial process.

SCOPE OF THE EXAMINATION

To accomplish the foregoing, the examination included:

1. A review of the guidelines, procedures, training plans and forms pertaining to depreciation adopted by the Companies for use in California in the handling of its first-party property claims, including any documentation maintained by the Companies in support of positions or interpretations of the California Insurance Code, Fair Claims Settlement Practices Regulations, and other related statutes, regulations and case law used by the Companies.

2. A review of the application of such guidelines, procedures, and forms, by means of an examination of a sample of individual claim files and related records. The individual claim files consisted of file notes, correspondence, estimates, inventories, photographs, receipts and any other documentation related to the claimed property. In the review of the individual claim files, the following factors were considered for compliance when the amount claimed was adjusted as a result of depreciation:

- Justification for the adjustment in the claim file
- Adjustment is discernible, measurable, itemized, and specified as to dollar amount
- Adjustment reflects a measurable difference in market value attributable to both the condition and the age of the property
- Adjustment for physical depreciation is based upon the pre-loss physical condition of the damaged, lost or stolen property at the time of the loss
- Basis of the adjustment was provided in writing to the claimant and reflects a measurable difference in market value attributable to the condition and age of the property
- Adjustment for betterment or depreciation is applied only to property normally subject to repair and replacement during the useful life of the property/structure

- Adjustment for depreciation is not applied to the expense of labor necessary to repair, rebuilt or replace covered property
- Treatment of recoverable depreciation, including disclosure of how a claim for recoverable depreciation can be accomplished, and application of time limit of no less than 12 months from the date first payment toward actual cash value is made to collect the recoverable depreciation

3. A review of consumer complaints and inquiries about the Companies closed by the CDI during the period June 1, 2013 through May 31, 2014 and a review of prior CDI market conduct claim examination reports on the Companies.

The review of the sample of individual claim files was conducted at the offices of the Companies in Rancho Cordova, California.

EXECUTIVE SUMMARY OF CLAIMS SAMPLE REVIEWED

The Homeowner and Commercial Property first-party claims reviewed were closed from June 1, 2013 through May 31, 2014, referred to as the "review period". The Homeowner claims populations were comprised of closed paid claims with both dwelling and personal property losses, and closed paid claims with personal property losses only. The Commercial Property claims populations were comprised of closed paid claims with both building and business personal property losses, and closed paid claims with business personal property only. If the Companies waived depreciation due to any internal thresholds, the Department requested the omission of these claims in the populations. The Companies indicated there were no thresholds for the Homeowner and Commercial Property claims. It was discovered during the file review that a $2,500.00 threshold existed for Homeowner claims throughout the review period. The examiners randomly selected 26 Homeowner claim files and 49 Commercial Property claim files for examination in proportion to the number of claims in each underwriting Company from these populations. Third-party administrators primarily handled the claims handling function for the Companies' Homeowner business.

The examiners cited 62 alleged claims handling violations of the California Insurance Code and the California Code of Regulations from this sample file review. The examination found that:

- The Companies' claim files did not include evidence that condition was used in the calculation of depreciation deducted from the identified claim files.
- The Companies failed to fully explain the basis for adjustments for depreciation to claimants in writing, which reflect a measurable difference in market value attributable to the condition and age of the property.
- The Companies improperly applied betterment or depreciation to property not normally subject to repair and replacement during the useful life of the property.

RESULTS OF REVIEWS OF CONSUMER COMPLAINTS AND INQUIRIES AND PREVIOUS EXAMINATIONS

The Companies were the subject of three California consumer complaints and inquiries related to Homeowner and Commercial Property first-party claims closed from June 1, 2013 through May 31, 2014. Within these three complaints, the CDI alleged five violations of law and determined two complaints were justified. The violations of law did not pertain to the depreciation practices of the Companies.

EFMIC was the subject of a prior regularly scheduled claims examination that reviewed claims closed during the period of July 1, 2000 through June 30, 2001. The examination did not include Homeowner and Commercial Property first-party claims. It covered the claims handling practices related to Private Passenger Automobile, Commercial Automobile and Comprehensive General Liability only.

FDCM was the subject of a prior regularly scheduled claims examination that reviewed claims closed during the period of March 1, 2005 through February 28, 2006. While depreciation practices were not specifically targeted in the examination, one alleged violation related to the application of depreciation to an insured's settlement when repairs had already been completed. This issue was not identified in the current examination.

UUIC was the subject of two prior regularly scheduled claims examinations. The first reviewed claims closed during the period of June 1, 2004 through May 31, 2005. While depreciation practices were not specifically targeted in the examination, two alleged violations related to an inadequate explanation of applied depreciation. This issue was also identified in the current examination. The second examination reviewed claims closed during the period of July 1, 2010 through June 30, 2011. The examination did not include Homeowner and Commercial Property first-party claims. It covered the claims handling practices related to Commercial Automobile only.

ZAIC, AZIC and AGLIC were the subjects of a prior regularly scheduled claims examination that reviewed claims closed during the period of September 1, 2012 through August 31, 2013. While depreciation practices were not specifically targeted in the examination, two alleged violations related to improperly applying betterment or depreciation to property not normally subject to repair and replacement during the useful life of the property and one alleged violation related to the failure to fully explain the basis for any adjustment to the claimant in writing. These issues were also identified in the current examination.

DETAILS OF THE CURRENT EXAMINATION

Further details with respect to the examination and alleged violations are provided in the following tables and summaries:

EFMIC SAMPLE FILES REVIEW (A)			
LINE OF BUSINESS / CATEGORY	**CLAIMS IN REVIEW PERIOD**	**SAMPLE FILES REVIEWED**	**NUMBER OF ALLEGED VIOLATIONS**
Homeowner Multiple Peril / First Party	35	22	34
TOTALS	35	22	3434

FDCM SAMPLE FILES REVIEW (B)			
LINE OF BUSINESS / CATEGORY	**CLAIMS IN REVIEW PERIOD**	**SAMPLE FILES REVIEWED**	**NUMBER OF ALLEGED VIOLATIONS**
Homeowner Multiple Peril / First Party	7	4	8
Commercial Property / ***Fire, Allied lines, Commercial multiple peril (non-liability portion), Earthquake, Burglary and theft / First Party	9	2	0
TOTALS	16	6	88

***Per FDCM, claims were drawn from the above policy types/categories.

ZAIC SAMPLE FILES REVIEW (C)			
LINE OF BUSINESS / CATEGORY	**CLAIMS IN REVIEW PERIOD**	**SAMPLE FILES REVIEWED**	**NUMBER OF ALLEGED VIOLATIONS**
Commercial Property / ***Fire, Allied lines, Commercial multiple peril (non-liability portion), Earthquake, Burglary and theft / First Party	100	28	7
TOTALS	100	28	77

***Per ZAIC, claims were drawn from the above policy types/categories.

UUIC SAMPLE FILES REVIEW (D)			
LINE OF BUSINESS / CATEGORY	**CLAIMS IN REVIEW PERIOD**	**SAMPLE FILES REVIEWED**	**NUMBER OF ALLEGED VIOLATIONS**
Commercial Property / ***Fire, Allied lines, Burglary and theft / First Party	29	8	7
TOTALS	29	8	77

***Per UUIC, claims were drawn from the above policy types/categories.

AZIC SAMPLE FILES REVIEW (E)			
LINE OF BUSINESS / CATEGORY	**CLAIMS IN REVIEW PERIOD**	**SAMPLE FILES REVIEWED**	**NUMBER OF ALLEGED VIOLATIONS**
Commercial Property / ***Fire, Allied lines, Commercial multiple peril (non-liability portion), Earthquake, Burglary and theft / First Party	22	6	4
TOTALS	22	6	44

***Per AZIC, claims were drawn from the above policy types/categories.

AGLIC SAMPLE FILES REVIEW (F)			
LINE OF BUSINESS / CATEGORY	**CLAIMS IN REVIEW PERIOD**	**SAMPLE FILES REVIEWED**	**NUMBER OF ALLEGED VIOLATIONS**
Commercial Property / ***Fire, Allied lines, Commercial multiple peril (non-liability portion), Earthquake, Burglary and theft / First Party	18	5	2
TOTALS	18	5	22

***Per AGLIC, claims were drawn from the above policy types/categories.

Of the 26 Homeowner claims reviewed, 11 did not involve depreciation and 15 were subject to depreciation. The 11 Homeowner claims with no depreciation involved the following: amounts under the $2,500.00 internal threshold for not taking depreciation; claims subject to limits (e.g. jewelry, cash, etc.); item(s) separately scheduled; mitigation/emergency services; or no reasons provided by the Companies for not applying depreciation. Other than the claims in which no explanation was provided by the Companies for not applying depreciation, depreciation is not applicable to these claims.

Of the 49 Commercial Property claims reviewed, 40 did not involve depreciation and nine were subject to depreciation. The 40 Commercial Property claims with no depreciation involved the following: repairs only or repairs completed prior to payment of the claim; item(s) new or business property inventories; no reasons provided by the Companies for not applying depreciation; actual cash value and replacement cost value are one and the same (e.g. vehicle, generator, trailer, etc.); item(s) replaced prior to payment of the claim; mitigation/emergency services; or claims subject to limits. Other than the claims in which no explanation was provided by the Companies for not applying depreciation, depreciation is not applicable to these claims.

TABLE OF TOTAL ALLEGED VIOLATIONS

Citation	Description of Allegation	A	B	C	D	E	F
CIC §§2051 and 2051.5/CCR §2695.9(f) *[CIC §790.03(h)(3)]	The Company failed to document in the claim file all justification for the adjustment of the amount claimed because of betterment, depreciation, or salvage. Any adjustment for betterment or depreciation shall reflect a measurable difference in market value attributable to the condition and age of the property.	15	3	3	2	2	1
CCR §2695.9(f) *[CIC §790.03(h)(3)]	The Company failed to fully explain the basis for any adjustment to the claimant in writing.	15	3	3	2	2	1
CCR §2695.9(f) *[CIC §790.03(h)(5)]	The Company improperly applied betterment or depreciation to property not normally subject to repair and replacement during the useful life of the property.	4	2	1	1	0	0
CCR §2695.9(f)(1) *[CIC §790.03(h)(5)]	The Company improperly applied depreciation or betterment to the expense of labor necessary to repair, rebuild or replace covered property.	0	0	0	1	0	0
CCR §2695.4(a) *[CIC §790.03(h)(1)]	The Company failed to disclose all benefits, coverage, time limits or other provisions of the insurance policy.	0	0	0	1	0	0
Total Number of Alleged Violations		**34**	**8**	**7**	**7**	**4**	**2**

A = Empire Fire and Marine Insurance Company (EFMIC)
B = Fidelity and Deposit Company of Maryland (FDCM)
C = Zurich American Insurance Company (ZAIC)
D = Universal Underwriters Insurance Company (UUIC)
E = American Zurich Insurance Company (AZIC)
F = American Guarantee and Liability Insurance Company (AGLIC)

*DESCRIPTONS OF APPLICABLE UNFAIR CLAIMS SETTLEMENT PRACTICES

CIC §790.03(h)(1)	The Company misrepresented to claimants pertinent facts or insurance policy provisions relating to any coverages at issue.
CIC §790.03(h)(3)	The Company failed to adopt and implement reasonable standards for the prompt investigation and processing of claims arising under insurance policies.
CIC §790.03(h)(5)	The Company failed to effectuate prompt, fair, and equitable settlements of claims in which liability had become reasonably clear.

TABLE OF ALLEGED VIOLATIONS BY LINE OF BUSINESS

HOMEOWNER **2013 Written Premium: $12,329,415** **2014 Written Premium: $11,491,754** **AMOUNT OF RECOVERIES $3,872.85**	**NUMBER OF ALLEGED VIOLATIONS**
CIC §§2051 and 2051.5 / CCR §2695.9(f) [CIC §790.03(h)(3)]	18
CCR §2695.9(f) [CIC §790.03(h)(3)]	18
CCR §2695.9(f) [CIC §790.03(h)(5)]	6
SUBTOTAL	**42**

COMMERCIAL PROPERTY **2013 Written Premium: $213,019,875** **2014 Written Premium: $235,831,340** **AMOUNT OF RECOVERIES $10,442.88**	**NUMBER OF ALLEGED VIOLATIONS**
CIC §§2051 and 2051.5 / CCR §2695.9(f) [CIC §790.03(h)(3)]	8
CCR §2695.9(f) [CIC §790.03(h)(3)]	8
CCR §2695.9(f) [CIC §790.03(h)(5)]	2
CCR §2695.4(a) [CIC §790.03(h)(1)]	1
CCR §2695.9(f)(1) [CIC §790.03(h)(5)]	1
SUBTOTAL	**20**

TOTAL	**62**

SUMMARY OF EXAMINATION RESULTS

The following is a brief summary of the criticisms that were developed during the course of this examination related to the violations alleged in this report.

In response to each criticism, the Companies are required to identify remedial or corrective action that has been or will be taken to correct the deficiency. The Companies are obligated to ensure that compliance is achieved.

Money recovered within the scope of this report was $14,315.73 as described in section numbers 1, 3, 4, 6 and 8 below. Pursuant to the findings of the examination as described in section numbers 1, 3, 4, and 6 below, the Companies are conducting closed claim surveys. The results of the surveys and additional payments, if any, shall be reported to the Department by September 15, 2016.

HOMEOWNERS' PROPERTY INSURANCE CLAIMS (HOMEOWNER)

1. In 18 instances, the Companies' claim files failed to contain all justification for the adjustment of the amounts claimed because of betterment, depreciation or salvage, and the adjustments failed to reflect a measurable difference in market value attributable to the condition, in addition to the age of, the property. Ten instances pertain to the depreciation of personal property. Eight instances pertain to the depreciation of the dwelling. In the files reviewed, the following situations were observed. The number of instances identified below total more than 18, as some claim files include more than one of the described situations.

a) In 12 instances related to both personal property and the dwelling, no letters or file notes could be located addressing condition as a component to the depreciation taken on the claim.

b) In 10 instances related to personal property, during the review period, the Companies made available its inventory form to assist the insured in providing a listing of personal property. The information obtained from the insured on this form is used to generate the personal property estimate that the Companies used as its written explanation for the basis of depreciation. The form does not include a column pertaining to condition. It includes columns for the description, purchased from, purchase date and cost. Additionally, the instructions provided either on the phone or in an initial letter do not include any direction related to the inclusion of the condition of the items when completing the form.

c) In six instances related to the dwelling, the adjuster report or the report from a vendor auditing the damages includes a standard notation stating that depreciation was based on the age and condition of the property. However, in practice, condition was not considered in the application of depreciation and the notes do not include the specifics of the actual condition of all property. For most of the property subject to depreciation, the files support a line by line deduction based on age alone.

d) In five instances related to the dwelling, the adjuster commented on the general condition of the risk. However, there are no comments regarding how the overall condition of the risk was used in the calculation of depreciation to the specific structural components damaged in the loss.

e) In two instances related to the dwelling, one estimate in each file includes an “age/life” and “usage” column. “Usage” is identified as “normal” for all dwelling items damaged in the loss. The rationale for the “normal” identifier was not explained or supported. The file does not reflect that condition of the items was considered when applying depreciation as the file notes are silent in this regard. Use/usage and condition do not have the same meaning. Usage is the amount of something that one uses and condition is the physical state of something.

f) In one instance related to the dwelling, the Company (EFMIC) deducted depreciation to structural components that were less than one year old. Internal depreciation guidelines instruct adjusters not to take depreciation to structural components less than one year old unless there are notes in the claim file to explain any deviation. This file did not contain any documentation justifying the depreciation that was taken.

g) In one instance related to personal property, the Company (EFMIC) applied depreciation to fine jewelry without any justification for doing so.

The Department alleges these acts are in violation of CIC §§2051 and 2051.5, and CCR §2695.9(f), and are unfair practices under CIC §790.03(h)(3). Specifically, there is no evidence that the Companies used condition in the calculation of the depreciation deducted in these claims.

<u>Summary of the Companies’ Response:</u> While the Companies acknowledge that all the depreciation applied was not supported with documentation as to age and condition, the Companies state it has adopted and implemented reasonable standards for the prompt investigation and processing of claims arising under its insurance policies.

To ensure future compliance, the Companies outlined the identified issues, the inconsistencies concerning calculations, depreciation application, and communication related to personal property and dwelling claims with its third-party administrators (TPAs) that handle California claims. The Companies informed the TPAs that age appeared to be the only item considered in the calculation of depreciation. The Companies also instructed the TPAs to include an area for the insured to identify the age and condition of an item in its inventory forms for personal property. When the TPA assigns an independent adjuster (IA) to write estimates, the Companies require the TPA to review the estimates to make certain that age, condition, and useful life are clearly shown on the estimate sheet and documented in the IA report. Any exceptions must be documented in the IA report, on the estimate and clearly communicated to the insureds. Additionally, TPAs were instructed never to take depreciation as a "lump sum" (e.g. 30% of the total estimate). There must be a valid reason for the application of depreciation and depreciation must be considered on a line by line basis. Future audits and file reviews will focus significantly on depreciation. The Companies conducted its review of the findings with the TPAs on October 27, 2014.

As an additional remedial measure, the Companies conducted internal training with claims staff the week of December 1, 2014, which included the delivery of a policies and procedural update. The Companies also worked with its vendor partners to enhance the Frequently Asked Questions (FAQs) document. This document is provided to an insured with a copy of the estimate. The FAQs includes a description of depreciation and the basis for taking depreciation. Vendors now incorporate age, life expectancy, and condition on structural estimates and on personal property inventories.

When depreciation is taken, the claim handler is required to discuss with the claimant the basis for the depreciation amount, including, but not limited to, the age, life expectancy and condition of the item(s) at issue. This depreciation discussion with the claimant is to be documented, with the date of discussion in the claim file. The claim file will include the letter sent to the claimant, which encloses the estimates and the new FAQs document showing the basis for depreciation. The claim file will also contain claim notes and all communication, verbal and in writing, with the claimant, that explains the basis for depreciation and the opportunity to recover the appropriate withheld amount, if items are replaced per a replacement cost policy.

As a result of the findings of this examination, the Companies reviewed all instances to determine if recoverable depreciation was pending. The Companies identified four instances where recoverable depreciation had not yet been paid. In these instances, the Companies either contacted the insured to confirm pre-loss condition, evaluate and re-calculate the depreciation taken, if appropriate, or re-reviewed the file and based upon this review, reimbursed the insured for some or all of the depreciation that was taken. As a result of the follow-ups and re-reviews, the Companies issued payments totaling $2,223.12.

As a result of the errors made in calculating depreciation to structural components less than a year old and to fine jewelry regarding 1(f) and 1(g) above, the Company issued payments totaling $802.02 to correct these two criticisms.

In response to the concern that the Companies did not address reimbursement for claimants whose claims were adjusted for depreciation without considering the condition of each item outside the identified claims in this examination, the Companies are conducting an internal survey of homeowner property claims closed over a review period of April 01, 2012 through March 31, 2015. The Companies estimate it will complete this survey by September 15, 2016.

Summary of the Department's Evaluation of the Companies' Response: The revisions the Companies have implemented in order to comply with the referenced insurance code and regulations appear to allow for consideration of the condition of items in determining the amount of depreciation to apply. The Department will continue to evaluate how the Companies document condition and apply depreciation.

2. In 18 instances, the Companies failed to fully explain the basis for any adjustment to the claimant in writing. Ten instances pertain to the depreciation of personal property. Eight instances pertain to the depreciation of the dwelling. The information provided by the Companies does not demonstrate that the Companies have provided claimants with written explanation of the basis for depreciation in these claim files.

Although a copy of the inventory/estimate and settlement letter were provided to the insured in the ten instances pertaining to personal property, the inventory/estimate and letter do not fully explain the basis for depreciation, which reflects a measurable difference in market value attributable to the condition and age of the property. The inventories/estimates detail the item description, settlement action, replacement cost, depreciation percentage, depreciation amount, actual cash value of each item, and in some instances, age was listed as well. No inventories, estimates or settlement letters include the condition of the items depreciated.

In six instances related to the dwelling, a copy of the Xactimate structural estimate and settlement letter were sent to the insured; however, the estimate and letter do not provide a written explanation for the basis of the depreciation taken, which reflects a measurable difference in market value attributable to the condition and age of the property. The estimate details the replacement cost, depreciation amount applied, and actual cash value of each structural component. It does not include the age, condition or useful life of the items depreciated. In two instances related to the dwelling, the estimate included age/life and usage columns although these estimates do not provide a sufficient written explanation for the basis of the depreciation taken to include condition as well.

The Department alleges these acts are in violation of CCR §2695.9(f) and are unfair practices under CIC §790.03(h)(3). Specifically, there is no evidence that the

Companies have provided claimants with written explanation of the basis for depreciation, which takes condition and age into consideration.

Summary of the Companies' Response: While the Companies acknowledge that it did not fully explain to the insured, in writing, the basis for depreciation contained in the inventories or estimates, the Companies state it has adopted and implemented reasonable standards for the prompt investigation and processing of claims arising under its insurance policies.

To ensure future compliance, the Companies outlined the identified issues, the inconsistencies concerning calculations, application, and communication regarding depreciation to personal property and dwelling claims with its TPAs that handle California claims. The Companies informed the TPAs that condition was not considered and that age appeared to be the only item considered in the calculation of depreciation. Written communication explaining how the depreciation was calculated was not provided to the insured (where written communication was provided, it did not contain an explanation). When the TPA assigns an IA to write estimates, the Companies require the TPA to review the estimates to make certain that age, condition, and useful life are clearly shown on the estimate sheet and documented in the IA report. Any exceptions must be documented in the IA report, on the estimate and clearly communicated to the insureds. There must be a valid reason for the application of depreciation and depreciation must be considered line by line. The Companies conducted its review of the findings with the TPAs on October 27, 2014.

As an additional remedial measure, the Companies conducted internal training with claims staff the week of December 1, 2014, which included the delivery of a policies and procedural update. The Companies also worked with its vendor partners to enhance the Frequently Asked Questions (FAQs) document. This document is provided to an insured with a copy of the estimate. The FAQs includes a description of depreciation and the basis for taking depreciation. Vendors now incorporate age, life expectancy, and condition on structural estimates and on personal property inventories. The claim file will include the letter sent to the claimant, which encloses the estimates and the new FAQs document showing the basis for depreciation. The claim file will also contain claim notes and all communication, verbal and in writing, with the claimant, that explains the basis for depreciation and the opportunity to recover the appropriate withheld amount, if items are replaced per a replacement cost policy.

Following the examination, the Companies instructed its vendors Xactware and Enservio (for personal property only) to initiate new programming regarding the factors affecting the amount of depreciation deducted. Instead of the factor and heading entitled “USAGE” (included in the Xactware program, which is a hidden column in most cases), the Companies instructed Xactware to utilize a factor and heading for “CONDITION”. The Companies also instructed Enservio to add a “Condition” column to its inventory sheets and software program. Any other personal property inventory sheets will similarly include a “Condition” column. The Companies further instructed Xactware to revise the definitions from the use-related descriptions of “Heavy”, “Normal” and “Light”, to the condition-related descriptions of “Below Average”, “Average”, and “Above Average”. The Xactware programming was completed on April 16, 2015. Enservio revised its condition-related descriptions to “New”, “Excellent”, “Good”, and “Fair”. The Enservio programming changes took place in December, 2014. A printed report containing the data points described will be provided to the claimant in all instances to serve as a written explanation of the basis for the depreciation taken.

Summary of the Department’s Evaluation of the Companies’ Response: The revisions the Companies have implemented and proposed in order to comply with the referenced insurance code and regulations appear to allow for appropriate written explanation to the claimant of the adjustment made, taking into account both the condition and the age of items depreciated. The Department will continue to evaluate the application of this process.

3. **In six instances, the Companies improperly applied betterment or depreciation to property not normally subject to repair and replacement during the useful life of the property.** In each instance, the Companies applied depreciation to one or more structural components not normally subject to repair and replacement during the useful life of the structure. The structural components in the instances noted are not normally subject to repair or replacement during the items’ lifespan absent some known reason to do so, such as damage sustained in an insurance loss. Additionally, the files notes at issue were void of any specific documentation regarding the condition of the items that would warrant betterment or depreciation. The Department alleges these acts are in violation of CCR §2695.9(f) and are unfair practices under CIC §790.03(h)(5).

Summary of the Companies’ Response: While the Companies acknowledge that depreciation was applied due to claim handler error, the Companies submit that it did attempt in good faith to effectuate prompt, fair, and equitable settlement of a claim in which liability had become reasonably clear. The claim handlers’ guidelines during the review period instructed claim handlers not to take depreciation on such items unless there is observable prior damage or wear and tear.

To ensure future compliance, the Companies outlined the identified issues, the inconsistencies concerning calculations, application, and communication regarding depreciation to personal property and dwelling claims with its TPAs that handle California claims. The Companies informed the TPAs that condition was not considered and that age appeared to be the only item considered in the calculation of depreciation. Depreciation is not to be taken on items not normally subject to depreciation (e.g. drywall, studs, etc.) without an exception reason being noted. Depreciation on these types of structural components should not be automatically applied without the rationale for doing so documented in the claim file. When the TPA assigns an IA to write estimates, the Companies require the TPA to review the estimates to make certain that age, condition, and useful life are clearly shown on the estimate sheet and documented in the IA report. Any exceptions must be documented in the IA report, on the estimate and clearly communicated to the insureds. There must be a valid reason for the application of depreciation and depreciation must be considered line by line. The Companies conducted its review of the findings with the TPAs on October 27, 2014.

When depreciation is taken, the claim handler is required to discuss with the claimant the basis for the depreciation amount, including, but not limited to, the age, life expectancy, and condition of the item(s) at issue. This depreciation discussion with the claimant is to be documented, with the date of discussion in the claim file. The claim file will include the letter sent to the claimant, which encloses the estimates and the new FAQs document showing the basis for depreciation. The claim file will also contain claim notes and all communication, verbal and in writing, with the claimant, that explains the basis for depreciation and the opportunity to recover the appropriate withheld amount, if items are replaced per a replacement cost policy.

As a result of the findings of the examination, the Companies issued payments totaling $847.41 in four of the six instances. In two instances, the insureds recovered the depreciation as a result of presenting proof of repairs.

In response to the concern that the Companies did not address reimbursement for claimants whose claims were adjusted for depreciation to property not normally subject to repair and replacement during the useful life of the property outside the identified claims in this examination, the Companies are conducting an internal survey of homeowner property claims closed over a review period of April 01, 2012 through March 31, 2015. The Companies estimate it will complete this survey by September 15, 2016.

<u>Summary of the Department's Evaluation of the Companies' Response:</u> The revisions the Companies have implemented in order to comply with the referenced insurance code and regulations appear to address items not normally subject to depreciation. The Department will continue to evaluate how the Companies document condition and apply depreciation to these structural components.

<u>COMMERCIAL PROPERTY INSURANCE CLAIMS</u>

4. <u>In eight instances, the Companies' claim files failed to contain all justification for the adjustment of the amounts claimed because of betterment, depreciation or salvage, and the adjustments failed to reflect a measurable difference in market value attributable to the condition, in addition to the age of, the property.</u> Seven instances pertain to the depreciation of business personal property. One instance pertains to the depreciation of the building. In the files reviewed, the following situations were observed. The number of instances identified below total more than eight, as one claim file includes more than one situation.

a) In seven instances related to business personal property, no letters or file notes could be located addressing condition as a component to the depreciation taken on the claim.

b) In one instance related to business personal property, the Company (ZAIC) applied an arbitrary and fixed percentage of depreciation to two groups of property and there is no evidence condition was considered in the calculation of the depreciation percentages taken.

c) In one instance related to the building (UUIC), the adjuster commented on the general condition of the risk. There are no comments regarding how the overall condition of the risk was used in the calculation of depreciation to the specific structural components damaged in the loss.

The Department alleges these acts are in violation of CIC §§2051 and 2051.5, and CCR §2695.9(f), and are unfair practices under CIC §790.03(h)(3). Specifically, there is no evidence that the Companies used condition in the calculation of the depreciation deducted in these claims.

Summary of the Companies' Response: While the Companies acknowledge that all the depreciation applied was not supported with documentation as to age and condition, the Companies state it has adopted and implemented reasonable standards for the prompt investigation and processing of claims arising under its insurance policies.

To ensure future compliance, the Companies outlined the identified issues, the inconsistencies concerning calculations, application, and communication regarding depreciation to business personal property and buildings with its property claim managers, property claims staff, and TPAs that handle California claims. The Companies informed the property claims staff and TPAs that condition was not considered and that age appeared to be the only item considered in the calculation of depreciation. When sending inventory forms for personal property for an insured to fill out, all were instructed to include an area for the insured to identify the age and condition of the item. When the TPA assigns an IA to write estimates, the Companies require the TPA to review the estimates to make certain that age, condition, and useful life are clearly shown on the estimate sheet and documented in the IA report. Any exceptions must be documented in the IA report, on the estimate and clearly communicated to the insureds. Additionally, claims staff and TPAs were instructed never to take depreciation as a "lump sum" (e.g. 30% of the total estimate). There must be a valid reason for the application of depreciation and depreciation must be considered line by line. Future audits and file reviews will focus significantly on depreciation. The Companies conducted its review of the findings with all claims staff and TPAs on October 24 and October 27, 2014.

The Companies also developed standards on what discussion is to take place with the insured and where this is to be documented including the application of how depreciation is to be calculated. Depreciation rationale will be documented in the damage analysis task in the Companies' internal claim system. The claim file will include all inventory sheets, estimates that are received, created or compiled, all written communication, photographs, adjuster and/or expert reports, and any other report or notes that are collected.

As an additional remedial measure, the Companies prepared and distributed a training PowerPoint presentation outlining the findings of the examination as well as the remedies noted above to appropriate personnel on or before December 31, 2014.

In the identified claims where recoverable depreciation has not yet been paid, the Companies either contacted the insured to confirm pre-loss condition, evaluate and re-calculate the depreciation taken, if appropriate, or re-reviewed the file and based upon this review, reimbursed the insured for depreciation that was taken. As a result of the follow-ups and re-reviews, the Companies issued payments totaling $4,784.86.

In response to the concern that the Companies did not address reimbursement for claimants whose claims were adjusted for depreciation without considering the condition of each item outside the identified claims in this examination, the Companies are conducting an internal survey of commercial property claims closed over a review period of April 01, 2012 through March 31, 2015. The Companies estimate it will complete this survey by September 15, 2016.

Summary of the Department's Evaluation of the Companies' Response: The revisions the Companies have implemented in order to comply with the referenced insurance code and regulations appear to allow for consideration of the condition of items in determining the amount of depreciation to apply. The Department will continue to evaluate how the Companies document condition and apply depreciation.

5. In eight instances, the Companies failed to fully explain the basis for any adjustment to the claimant in writing. Seven instances pertain to the depreciation of business personal property. One instance pertains to the depreciation of the building. The information provided by the Companies does not demonstrate that the Companies have provided claimants with written explanation of the basis for depreciation in these claim files.

Although a copy of the property details estimate for business personal property and a copy of the Xactimate structural estimate for the building were provided to the insured, these estimates do not fully explain the basis for depreciation, which reflects a measurable difference in market value attributable to the condition and age of the property. The estimates detail the replacement cost, depreciation amount applied; actual cash value of each item, and in some instances, age was listed as well. None of the estimates include the condition of the items depreciated.

The Department alleges these acts are in violation of CCR §2695.9(f) and are unfair practices under CIC §790.03(h)(3). Specifically, there is no evidence that the Companies have provided claimants with written explanation of the basis for depreciation, which takes condition and age into consideration.

Summary of the Companies' Response: While the Companies acknowledge that it did not fully explain to the insured, in writing, the basis for depreciation contained in the estimates, the Companies state it has adopted and implemented reasonable standards for the prompt investigation and processing of claims arising under its insurance policies.

To ensure future compliance, the Companies outlined the identified issues, the inconsistencies concerning calculations, application, and communication regarding depreciation to business personal property and buildings with its property claim managers, property claims staff, and TPAs that handle California claims. The Companies informed the property claims staff and TPAs that condition was not considered and that age appeared to be the only item considered in the calculation of depreciation. Written communication explaining how the depreciation was calculated was not provided to the insured (where written communication was provided, it did not contain an explanation). When the TPA assigns an IA to write estimates, the Companies require the TPA to review the estimates to make certain that age, condition, and useful life are clearly shown on the estimate sheet and documented in the IA report. Any exceptions must be documented in the IA report, on the estimate and clearly communicated to the insureds. There must be a valid reason for the application of depreciation and depreciation must be considered line by line. The Companies conducted its review of the findings with all claims staff and TPAs on October 24 and October 27, 2014.

The Companies also developed standards on what discussion is to take place with the insured and in what manner the basis for depreciation is provided in writing. Depreciation rationale will be documented in the damage analysis task in the Companies' internal claim system. The claim file will include all inventory sheets, estimates that are received, created or compiled, all written communication to the insured explaining the bases for depreciation, photographs, adjuster and/or expert reports, and any other report or notes that are collected.

As an additional remedial measure, the Companies prepared and distributed a training PowerPoint presentation outlining the findings of the examination as well as the remedies noted above to appropriate personnel on or before December 31, 2014.

Following the examination, the Companies instructed its vendors Xactware and Enservio (for personal property only) to initiate new programming regarding the factors affecting the amount of depreciation deducted. Instead of the factor and heading entitled "USAGE" (included in the Xactware program, which is a hidden column in most cases), the Companies instructed Xactware to utilize a factor and heading for "CONDITION". The Companies also instructed Enservio to add a "Condition" column to its inventory sheets and software program. Any other personal property inventory sheets will similarly include a "Condition" column. The Companies further instructed Xactware to revise the definitions from the use-related descriptions of "Heavy", "Normal" and "Light", to the condition-related descriptions of "Below Average", "Average", and "Above Average". The Xactware programming was completed on April 16, 2015.

Enservio revised its condition-related descriptions to “New”, “Excellent”, “Good”, and “Fair”. The Enservio programming changes took place in December, 2014. A printed report containing the data points described will be provided to the claimant in all instances to serve as a written explanation of the basis for the depreciation taken.

Summary of the Department’s Evaluation of the Companies’ Response: The revisions the Companies have implemented and proposed in order to comply with the referenced insurance code and regulations appear to allow for appropriate written explanation to the claimant of the adjustment made, taking into account both the condition and the age of items depreciated. The Department will continue to evaluate the application of this process.

6. In two instances, the Companies improperly applied betterment or depreciation to property not normally subject to repair and replacement during the useful life of the property. In each instance, the Companies applied depreciation to one or more structural components not normally subject to repair and replacement during the useful life of the structure. The structural components in the instances noted are not normally subject to repair or replacement during the items’ lifespan absent some known reason to do so, such as damage sustained in an insurance loss. Additionally, the files notes at issue were void of any specific documentation regarding the condition of the items that would warrant betterment or depreciation. The Department alleges these acts are in violation of CCR §2695.9(f) and are unfair practices under CIC §790.03(h)(5).

Summary of the Companies’ Response: While the Companies acknowledge that depreciation was applied due to claim handler error, the Companies submit that it did attempt in good faith to effectuate prompt, fair, and equitable settlement of a claim in which liability had become reasonably clear. The Companies do not consider these items normally subject to repair and replacement during the useful life of the property, unless there is observable prior damage or wear and tear.

To ensure future compliance, the Companies outlined the identified issues, the inconsistencies concerning calculations, application, and communication regarding depreciation to business personal property and buildings with its property claim managers, property claims staff, and TPAs that handle California claims. The Companies informed the property claims staff and TPAs that condition was not considered and that age appeared to be the only item considered in the calculation of depreciation. Depreciation is not to be taken on items not normally subject to depreciation (e.g. drywall, studs, etc.) without an exception reason being noted. Depreciation on these types of structural components should not be automatically applied without the rationale for doing so documented in the claim file. When the TPA assigns an IA to write estimates, the Companies require the TPA to review the estimates to make certain that age, condition, and useful life are clearly shown on the estimate sheet and documented in the IA report. Any exceptions must be documented in the IA report, on the estimate and clearly communicated to the insureds. There must be a valid reason for the application of depreciation and depreciation must be considered line by line. The Companies conducted its review of the findings with all claims staff and TPAs on October 24 and October 27, 2014.

The Companies also developed standards on what discussion is to take place with the insured and where this is to be documented including the application of how depreciation is to be calculated. Depreciation rationale will be documented in the damage analysis task in the Companies' internal claim system. The claim file will include all inventory sheets, estimates that are received, created or compiled, all written communication, photographs, adjuster and/or expert reports, and any other report or notes that are collected.

As an additional remedial measure, the Companies prepared and distributed a training PowerPoint presentation outlining the findings of the examination as well as the remedies noted above to appropriate personnel on or before December 31, 2014.

As a result of the findings of the examination, the Companies issued payments totaling $5,658.02 in both instances. This amount also includes the depreciated labor noted in section number eight below.

In response to the concern that the Companies did not address reimbursement for claimants whose claims were adjusted for depreciation to property not normally subject to repair and replacement during the useful life of the property outside the identified claims in this examination, the Companies are conducting an internal survey of commercial property claims closed over a review period of April 01, 2012 through March 31, 2015. The Companies estimate it will complete this survey by September 15, 2016.

Summary of the Department's Evaluation of the Companies' Response: The revisions the Companies have implemented in order to comply with the referenced insurance code and regulations appear to address items not normally subject to depreciation. The Department will continue to evaluate how the Companies document condition and apply depreciation to these structural components.

7. In one instance, the Company (UUIC) failed to disclose how a claim for recoverable depreciation can be accomplished. The Department alleges this act is in violation of CCR §2695.4(a) and is an unfair practice under CIC §790.03(h)(1).

Summary of the Company's Response: While the Company acknowledges that it did not fully provide the insured with an explanation regarding recoverable depreciation and how a claim for recoverable depreciation can be made, the Company submits that it did not knowingly misrepresent to claimants pertinent facts or insurance policy provisions relating to any coverages at issue. The Company's standard procedure, once it confirms the pre-loss condition and evaluates the depreciation taken, is to fully explain to the insured, in writing, recoverable depreciation and how the claim for recoverable depreciation can be made. The Company reviewed the procedures regarding this disclosure requirement with its property claim managers, property claims staff, and TPAs that handle California claims to ensure future compliance. The

Companies conducted its review of the findings with all claims staff and TPAs on October 24 and October 27, 2014.

8. <u>In one instance, the Company (UUIC) improperly applied depreciation or betterment to the expense of labor necessary to repair, rebuild or replace covered property.</u> Specifically, depreciation was applied to the labor associated with setup and tear down for a small job. The Department alleges this act is in violation of CCR §2695.9(f)(1) and is an unfair practice under CIC §790.03(h)(5).

<u>Summary of the Company's Response:</u> The Company acknowledges that depreciation was taken on this item in error and submits that it did attempt in good faith to effectuate prompt, fair, and equitable settlement of a claim in which liability had become reasonably clear. The Company reviewed this regulation with its property claim managers, property claims staff, and TPAs that handle California claims to ensure future compliance. The Companies conducted its review of the findings with all claims staff and TPAs on October 24 and October 27, 2014. As an additional remedial measure, the Companies prepared and distributed a training PowerPoint presentation outlining the findings of the examination as well as the remedies noted above to appropriate personnel on or before December 31, 2014.

As a result of this finding, the Company issued a payment identified in section six above for the amount depreciated for labor.