DELAWARE MARKET CONDUCT EXAMINATION

OF

WESCO INSURANCE COMPANY

AS OF

DECEMBER 16, 2005

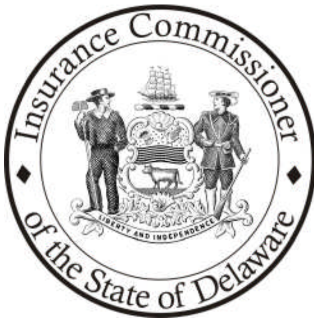
I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON MARKET CONDUCT EXAMINATION, made as of DECEMBER 16, 2005 of the

WESCO INSURANCE COMPANY

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

ATTEST BY: ______________________________

DATE: 15 MAY 2006



In Witness Whereof, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 15TH DAY OF MAY 2006.

____
Insurance Commissioner

REPORT ON MARKET CONDUCT EXAMINATION

OF THE

WESCO INSURANCE COMPANY

AS OF

DECEMBER 16, 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.

MATTHEW DENN
INSURANCE COMMISSIONER

DATED this 15TH day of MAY, 2006.

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SALUTATION

January 11, 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 05.729, and pursuant to statutory provisions including 18 Del. C. §318-322, a market conduct examination has been conducted of the affairs and practices of:

Wesco Insurance Company

hereinafter referred to as the "Company" or as "Wesco." Wesco Insurance Company is incorporated under the laws of the State of Delaware. This examination reviewed the operations of Wesco. The on-site phase of the examination was conducted at the following location:

200 Somerset Corporate Blvd. Suite 100, Bridgewater, NJ 08807

The examination is as of December 16, 2005.

Examination work was also conducted 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 are:

- 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 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 results indicated. Substantial departure from the norm may result in a supplemental review focused on the area so noted.

HISTORY AND PROFILE

Wesco Insurance Company was incorporated under the laws of the State of New Mexico on December 12, 1962, and re-domesticated to the State of Delaware on August 14, 1991. On July 9, 1993, Registrant was acquired by Beneficial Insurance Group Holding Company ("BIG") from Consolidated Insurance Group of America, Inc. On July 12, 1993, Wilmington Property and Casualty Insurance Company, also a wholly subsidiary of BIG, was merged with and into Registrant, with Registrant being the surviving company. Prior to June 30, 1998, Registrant was a wholly owned subsidiary of BIG, a wholly owned subsidiary of Beneficial Corporation, which became a wholly owned Subsidiary of HII, which in turn is a wholly owned subsidiary of HSBC Holdings plc, a United Kingdom Corporation, which is the "ultimate controlling person" of Registrant.

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 Market Conduct Examiners' Handbook.

The types of review used in this examination fall into three general categories: generic, sample, and electronic.

A "generic" review indicates that the review was conducted 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 the review was conducted through direct review of a random sample of files using sampling methodology described in the Delaware Market Conduct Examiners' Handbook and the NAIC Market Conduct Examiners' Handbook. 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.

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

The complaints pattern review was conducted using all three methodologies described above. The various procedures were reviewed using a "generic" review methodology.

The Introduction to the Review of Procedures section describes the basis for the analysis methodology. Each procedure reviewed is described and the result of the review is provided under the appropriate procedure. Each procedure is supported by 18 Del. C. §318(a) and 18 Del. C. §508(b). In some cases there is additional specific statutory support, however, these have not been enumerated. The reference source for each procedure found in the NAIC Market Conduct Examiners' Handbook (*NAIC MCEH Reference*) is noted.

Each procedure is accompanied by the examiners' "Observations." In some cases a "Recommendation" is made. Reference, Observations and Recommendations are reported with the appropriate Standard.

A. COMPANY OPERATIONS/MANAGEMENT

The memorandum of this examination is analytical with recommendations made where applicable. There are two standards that are evaluated on a pass/fail basis. Standards A-07 and A-09 are stipulated as follows:

- "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 A 07

NAIC Market Conduct Examiners' Handbook - Chapter VIII, §A, Standard 07.

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

18 Del. C. §318(a), §505(b), §508(b).

Comments: The review for this standard is by "generic" methodology. This standard has a direct insurance statutory requirement. This standard is intended to ensure that the Company operations are in conformance with the Company's Certificate of Authority.

Results: **Pass**

Observations: The Company is licensed for the lines of business being written.

Recommendations: None

Standard A 09

NAIC Market Conduct Examiners' Handbook - Chapter VIII. §A, Standard 09.
The Company cooperates on a timely basis with examiners performing the examinations.
18 Del. C. §318(a), §320(c), §508(b), §520(b)3.

Comment: The review for this standard is by "generic" methodology. 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 examiners in the conduct of an examination is not only required by statute, it is conducive to completing the examination in a timely fashion and minimizing cost.

Results: **Pass, but needs improvement**

Observations: During the course of the examination, Wesco was provided fifty-three (53) Information Requests (IRs) and twenty-two (22) responses and forty-two percent (42%), were returned on-time. The remaining IRs wee provided within a week and two responses needed additional information from the Company in order for the examiners to complete the review.

Recommendations: It is recommended that the Company take the needed steps to improve response time with the examiners.

B. COMPLAINTS/GRIEVANCES

Comments: Evaluation of the Standards in this business area is based on Company response to various information requests (IR items) and complaint files at the Company. 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 ninety four (94) logged complaints for the period of examination. All complaints were reviewed for a pattern of problems relating to coverage. All complaints based on denial of benefits were a result of exclusions and limits properly listed in the underlying policies. All complaints based on issuance of policies (behavior of agent) were resolved with a refund of premium. No discernible pattern of consumer harm was noted.

G. CLAIMS PRACTICES

The evaluation of standards in this business area is based on Company responses to information items requested by the examiner, discussions with Company staff, electronic testing of claim databases, and file sampling during the examination process. This portion of the examination is designed to provide a view of how the company treats claimants and whether that treatment is in compliance with applicable statutes, rules and regulations.

Standard G 05

NAIC Market Conduct Examiners' Handbook - Chapter VIII, §G, Standard 5.

File documentation adequately supports decisions made.

18 Del. C. §318(a), §508(b), & §2304(1).

Comments: The review for this standard is by "sample" methodology. This standard does not have a direct insurance statutory requirement. When underwriting is performed with less than the required information, the likelihood of unfair discrimination increases.

Results: **Pass**

Observations: A random sample of files, as noted in the following table, was reviewed from the listing of contracts not paid during the examination period. Concerns tested with this Standard include:

- Underwriting file contains complete and signed application.
- Application contains sufficient information to identify exposure.

Underwriting Sample Results **Table G5-1**

Type	**Sampled**	**Pass**	**Fail**	**NA**	**% Pass**
Ind. Not Paid	51	50	0	1	**100%**
Totals	51	50	0	1	**100%**

During the course of the examination the Exam Team reviewed some Company responses that indicated that post claim underwriting might be present. Additional tests were applied and no evidence of post claim underwriting was found.

Recommendations: None

Standard G 09

NAIC Market Conduct Examiners Handbook - Chapter VIII, §G, Standard 9.

Denied and closed-without-payment claims are handled in accordance with policy provisions and state law.

18 Del. C. §318(a), §508(b), §2304(16)d, §2304(16)n & Del. Reg. 26 §(1)(d), Del. Reg §(1) (n)

Comments: The review for this standard is by "electronic" and "sample" methodology. This standard has a direct insurance statutory requirement.

Results: **Pass**

Observation: A random sample of Closed Without Payment Claims was selected and reviewed from the listings of Claims made during the examination period. Concerns tested with this Standard include:

- Denied and closed-without-payment claims are based on policy provisions and applicable Delaware statutes and regulations.
- Notices of claim denials reference specific policy provisions or exclusions.
- Claimants are provided with a reasonable basis for the denial when required by statute or regulation.

Claims Sample Results **Table G9-1**

Type	Sampled	Pass	Fail	NA	% Pass
Ind. Not Paid	51	50	0	1	**100%**
Totals	51	50	0	1	**100%**

Recommendations: None

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 where 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 a means to 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 Procedure (Internal and External)

Observations: The Company has a written audit procedure for internal audits. This procedure is undated. The procedure is clear and readable and accessible to the people it affects. The Company provides adequate training to people who are required to use or implement the procedure. The audit procedure does not appear to conflict with Delaware statutes and regulations.

The stated mission of the internal audit department is to provide independent, objective assurance and consulting services designed to add value and improve the organization's operations. The purpose of internal audit is to help accomplish organizational objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. The Company stresses the following elements for all internal audit work:

- identification of risks
- interaction with various segments of management
- accuracy and timeliness of financial, managerial, and operating information
- employee compliance with policies, standards, and procedures
- efficient use of resources
- adequate protection of resources
- measurement of program and plan goals
- continuous improvement of Company controls
- recognition of legislative and regulatory issues

The Senior Executive Vice President ("SEVP") Audit is accountable to management and the Board appointed audit committee. The SEVP duties are to provide an annual assessment on the adequacy and effectiveness of the organization's processes for controlling its activities and managing its risks; to report significant issues related to the processes for controlling the activities of the organizations and its affiliates on a timely basis; to provide information on the status and results of the annual audit plan and the sufficiency of department resources; and, to coordinate with and provide oversight of other control and monitoring functions (e.g., risk management, compliance, corporate security, legal, and external audit).

In order to provide independence of the internal auditing department, its personnel report to the SEVP Audit, who reports to the Directors of the Audit and Examining Committee of HSBC Bank USA, the ultimate parent of the Company. The SEVP also reports to HSBC Holdings plc's

Group General Manager – Internal Audit and to the Chief Executive Officer, HSBC North America, Inc.

The internal audit department has the responsibility to:

- develop a flexible annual audit plan using an appropriate risk-based methodology, including any risks or control concerns identified by management, and submit that plan to the audit committee for review and approval as well as perform periodic updates;
- implement the annual audit plan, as approved, including as appropriate any special tasks or projects requested by management and the audit committee;
- maintain a professional audit staff;
- evaluate and assess significant merging/consolidating functions and new or changing services, processes, operations, and control processes;
- issue periodic reports to the audit committee and management, summarizing the results of audit activities;
- keep the audit committee informed of emerging trends and successful practices in internal auditing;
- provide a list of significant measurement goals and results to the audit committee;
- assist in the investigation of significant suspected fraudulent activities within the organization and notify management and the audit committee of the results;
- consider the scope of external auditors and regulators for the purpose of providing optimal audit coverage to the organization at a reasonable cost.

The SEVP Audit and staff are authorized to have unrestricted access to all functions, records, property, and personnel. All members of the internal audit department have unrestricted access to the Board appointed audit committee. The audit team can allocate resources, select subjects, determine scopes of work, and apply the techniques required to accomplish audit objectives. The staff is also authorized to obtain the necessary assistance of personnel in units of the organization under audit, as well as specialized services from within or outside the organization.

The SEVP Audit and staff are not authorized to perform any operational duties for the organization or its affiliates; initiate or approve accounting transactions external to the internal auditing department; or, direct the activities of any organization employee not employed by the internal auditing department, except to the extent such employees have been appropriately assigned to the auditing teams or to otherwise assist the internal auditors.

Recommendations: None

Procedure 02 – Assertions of Privilege Procedure

Observations: The Company stated that assertion of privilege is determined by the legal department on a case by case basis. Examiners noted that there is no pattern of complaints or abuses regarding assertion of privilege evident in other procedure responses.

Recommendations: None

Procedure 03 – Company records, central recovery and backup procedure

Observations: The Company stated that hard copy claim files are retained for seven (7) years, and electronic files are retained indefinitely. Please refer to Procedure 06 for a review of disaster recovery and record keeping procedure implemented by the company.

Recommendations: None

Procedure 04 – Computer Security Procedure

Observations: The Company produced a document dated October 11, 2005 which stated that access to workstations, servers, and applications all require authentication. This authentication is controlled by the HSBC Security group, which monitors and maintains access to these facilities. All access and control protocols are implemented through the HSBC connect Web site through the use of work flow forms. Managers are required to submit documented requests for access by their respective employees. There are many areas that require specific access. All access control processes are clearly documented in the corporate Web site and are governed and managed by control points, managers responsible, and areas addressed.

The document did not address specifics, management review and control, or testing procedures for security.

Recommendation: It is recommended that the Company create a written computer security procedure that clearly displays management review and control, and testing procedures.

Procedure 05 – Anti Fraud Procedure

Observations: The Company has a formal written anti-fraud procedure. The procedure is unambiguous, clear, readable, and available to persons affected. Measurement structures and management oversight and control are incorporated within the procedure.

The anti-fraud requirement in the state of Delaware consists of the following:

1. Require fraud warning on documents and benefit checks
2. Mandatory reporting to the bureau when a reasonable belief exists that insurance fraud is being, or has been committed

The mandatory reporting is a function of the SIU at the claim investigator level, generally at the conclusion of the SIU investigation. Delaware has a referral form that is required to be used, as do most states with this requirement.

The Company trains all new hires and existing employees on insurance fraud identification, the effect of fraud on claims, and the Company's procedures for handling suspected fraud. The procedures are specific to job function in the following areas: underwriting detection, claim detection, special investigation (“SIU”), and investigation.

Underwriting training involves application review, medical reports, and other evidence of insurability. Claim detection training is based on claim forms, a re-review of applications, and evidence of loss. The SIU is responsible for communication within the Company to state law enforcement personnel.

All new personnel receive no less than nine (9) hours of classroom instruction. Continuing education in anti-fraud training is no less than nine (9) hours per year for SIU personnel, and four (4) hours per year for claims and underwriting personnel.

SIU personnel are required to have at least a Bachelor degree, a background in law enforcement, and experience with insurance related employment.

Recommendations: None.

Procedure 06 – Disaster Recovery Procedure

Observations: The Company has an extensive program in place ensuring business continuity. The organization is called Insurance Services ("IS"), and is composed of personnel from the following departments: Claims, New Business, Underwriting, Licensing, XyBernet Support, Quality Assurance, Business Quality Control, Finance and Marketing.

Each business unit within the Company is responsible for developing the response and recover strategy that is documented in their continuity plan. Each plan has a plan owner that executes the plan based on the recovery strategy. The plan development process also includes exercising, testing, and maintenance of the documented plan.

Once it is possible to resume business functions, the Company has established a checklist, reviewed by IS, in order to reestablish business functions at the Company's office.

Recommendations: None.

Procedure 07 – MGA Oversight and Control Procedure

Observations: The Company stated that it does not use managing general agents.

Recommendations: None.

Procedure 08 – Vendor Oversight and Control Procedure

Observations: The Company provided a cursory response stating they use Crawford and Company to investigate personal property and mortgage protection claims. The Company provided a manual of procedures governing goods and services provided by outside vendors. According to the manual, all vendors are assigned a risk assessment designation. A review of each vendor is performed on a time line based on a high, medium, low assessment. In addition, vendors are assigned classes such as Real Estate, Technology Contract, Foreign Vendors, and General Vendors. Review, due diligence and risk assessment is partially dependent on these

classes. The vendor relationship manager's involvement and oversight will vary depending on the complexity and risk ranking of the relationship.

Recommendation: None

Procedure 09 – Customer and Consumer Privacy Protection Procedure

Observations: The Company has a written customer and consumer privacy protection procedure. The procedure is clear and is dated November 2004. No conflict with Delaware statutes and regulations was noted.

The non-health care personal and nonpublic information obtained by the Company is protected under the Gramm-Leach-Bliley Act ("GLB") and it's implementing regulations. GLB requires a financial institution to provide a privacy policy to its customers, and describes the conditions under which such institution can disclose a customer's personal information to unaffiliated third parties.

The Company provides privacy notices in compliance with the GLB, both when first establishing a relationship with a consumer, and annually thereafter. The privacy notice contains required disclosures.

The Company provides the consumer with a clear and conspicuous opt-out notice. This notice states that the Company discloses, or reserves the right to disclosure, nonpublic personal information to nonaffiliated third parties; that the consumer has the right to opt out of that disclosure; and, the notice shows the means by which the consumer can exercise the opt-out right.

As per the Health Insurance Portability and Accountability Act ("HIPPA"), any misuse or dissemination of a customer's confidential medical information for another purpose other than insurance underwriting, claims, or audit purposes is a violation of Company policy.

Recommendations: None

Procedure 10 – Insurance Information Management Procedure

Observations: The Company produced a document dated October 11, 2005 which states that access to workstations, servers, and applications require authentication. This authentication is controlled by the HSBC Security group, which monitors and maintains access to these facilities. All access and control protocols are implemented through the HSBC connect Website through the use of work flow forms. Managers are required to submit documented requests for access by their respective employees. There are many areas that require specific access and all access control processes are clearly documented in the corporate Website, and are governed and managed by control points.

The same document was also provided for Procedure 4 and did not address specifics, management review and control, or testing procedures for security.

Recommendation: It is recommended that the Company create a written computer security procedure that clearly displays management review and control, and testing procedures.

Procedure 11 – Complaint Handling Procedure

Observations: The Company has a written complaints procedure. The procedure is undated. The procedure is clear and readable, and is accessible to the people affected. The Company provides adequate training to those persons the procedure affects.

The Company defines a “complaint” to mean any written communication primarily expressing a grievance (the NAIC Model Regulations for Complaint Records definition). A complaint may be filed with an insurance commissioner/department, any other regulatory authority, or sent directly to the company by the insured or the insured's representative. A complaint may be written or verbal.

The responsibility for handling the complaint is determined by the basis upon which the complaint was generated. The Claims Department is responsible for complaints in reference to a claim, possible claim, denial, or requests for information governing making a claim. The Quality and Assurance Department is responsible for complaints in reference to the loan office, and for problems with how the product was offered or sold. New Business is responsible for complaints in reference to cancellations, inquiries on old policies, and underwriting. The Legal Department is responsible for all subpoenas, notice of lawsuit or other legal proceedings.

Proposed resolutions by the various departments above are reviewed by Household Insurance Services, which issues the letter of resolution to the customer or appropriate authority.

When initially received, communications deemed complaints under the Company definition are handled by the Compliance Department. It is the responsibility of this department to perform the following tasks:

- all complaints are date stamped, reviewed and circulated to all direct report managers;
- a circulation sheet accompanies the complaint and determines who is to answer the complaint and the date the answer is due;
- documentation of the complaint is made based upon the requirements of the Model Regulation for Complaint Records to be Maintained Pursuant to the NAIC Unfair Trade Practices Act;
- all documentation corresponding to each complaint listed on the log must be filed together; and
- all complaint documentation must be secured due to the confidential nature of the information.

Recommendations: No time constraints were noted on the required complaint handling procedures. The procedures themselves appear adequate, however, because of the time-sensitive nature of this type of insurance primarily designed to pay debts of the insured, it is recommended that the Company’s complaint procedures incorporate time limits. It is also recommended that

the Company date their procedures in order to track the relevance of the procedures as compared to NAIC and state regulatory mandates and guidelines.

Procedure 13 – Advertising, sales and marketing Procedure

Observations: The Company provided a formal written procedure governing advertising of its products. According to the procedure, the following actions are in place:

Policy Forms Compliance (PFC) reviews all advertising and marketing materials for compliance with State laws. Contract Analyst will obtain advertising materials from Marketing and Implementation, for which a review of the advertisement will be conducted and any necessary adjustments with regards to the product and its contents are made.

All advertisements are reviewed for the following:

- truth/misleading information, both in fact and by implication
- required disclosures
- lay person language
- restricted words
- prohibited words
- product ID
- exceptions, exclusions, reductions and limitations
- competition
- renewability and cancelability
- dividends
- premium
- reduced initial premium
- ID of Plan/No. Of Policy
- material omission
- graded/modified benefits
- testimonials and endorsements
- illustrations
- legal right or privilege
- Financial condition of policy
- name
- form/series number
- special class/group
- direct mail
- statistics
- investment/tax features

Recommendations: None

Procedure 14 – Agent produced advertising Procedure

Observations: Per Company response, agents do not produce advertising.

Recommendations: None

Procedure 15 – Producer Training Procedure

Observations: The Company's products are point-of-sale at lending institutions, sold by employees of the lending institutions who are also licensed as an agent. The Company itself does not sell products through agent-employees. In response to this information request the Company produced a promotional manual giving step by step instruction in the use of Company provided software. Market conduct issues regarding sale of the credit insurance offered by the Company generally originate from the lending institutions selling the insurance.

Recommendations: None.

Procedure 20 – Producer Selection, Appointment and Termination Procedure

Observations: All producers are Company employees. The Company uses no 'field' agents or independent agents. Employee hiring and termination is handled as per Company employee guidelines.

Recommendations: None.

Procedure 21 – Producer Defalcation Procedure

Observations: The Company replied that all producers are employees of HFC and Beneficial offices. They do not handle any premium because the premium payment is part of the loan payment.

Recommendations: None

Procedure 22 – Prevention of use of persons with felony conviction Procedure

Observations: All producers are employees of the Company. All applications are reviewed by the Licensing Coordinator responsible for the state. If the applicant answered "yes" to the criminal history question, the application is referred to the Licensing Manager. The Manager reviews all the documentation and written statements. If there is a felony conviction, the Manager will review the file with Legal Counsel and/or the Compliance Officer. Determination will then be made on how to proceed.

Recommendations: None

Procedure 23 – Policyholder service Procedure

Observations: The Company has a written audit procedure for policyholder services. This procedure is clear and is dated June, 2004. No conflict with Delaware statutes and regulations was noted.

The procedure provided has a screen by screen process for canceling the policy. A part of the cancellation procedure is to submit a form to the Research Department. A copy of the form is sent to the submitter's in box. The submitter also gets a copy of the form once the Research Department has completed the form. These forms are filed in a folder in the Customer Service Representative's in box. During the Monthly Audit, if the New Business Department finds that a customer's request is not processed the New Business Representative then retrieves copies of the forms that were sent to the in box, and forwards them to the Unit Manager of the Research Department questioning why the request was never processed. The Representative is also responsible for tracking the count of received and cancelled Cancellation Requests. The New Business Manager reviews these numbers during Month End to ensure the number received is the same as the number processed.

Monthly Reporting is sent to the Financial Reporting Department. The numbers are gathered from a SAR report and an Excel Spreadsheet. The Representative's numbers should match the end of the month numbers in the department spreadsheets. The Representative e-mails these numbers to the Financial Reporting Department, the Manager of the BQC Department, and the Manager of the New Business Department. If the numbers do not match for any reason, the Representative must provide an explanation and correct the issue.

OR

The procedure provided has a screen by screen process for canceling the policy.

A request to cancel the policy is sent to the Research Department, who then copies the Customer Service Representative (CSR) with an e-mail, once the request has been processed. During the Monthly Audit, if the New Business Department finds that a customer's request has not been processed the original request and any other pertinent information is retrieved and the process is researched. Monthly Reporting is sent to the Financial Reporting Department. The numbers are gathered from a SAR report and spreadsheet. If the numbers do not match for any reason, the CSR must provide an explanation and correct the issue.

The CSR is also responsible for tracking the count of received and cancelled Cancellation Requests. The New Business Manager reviews these numbers during Month End to ensure the number received is the same as the number processed.

Recommendations: None

Procedure 24 – Premium Billing Procedure

Observations: The Company produced a written narrative of how premium is calculated. The formula is calculated based upon the amount of credit card outstanding balance. There is no noted system of oversight and control of the calculations. The Company also described the procedure used in the event the insured requests a refund.

Recommendations: The narrative regarding premium billing provided by the Company showed no measurement structure, management oversight, or management control. It is recommended that the Company incorporate controls into the premium billing procedure.

Procedure 25 – Correspondence Routing Procedure

Observations: The Company provided a cursory statement that claims are delivered to the Claims department by clerical staff.

Recommendations: It is recommended that the Company implement dated and detailed procedures for correspondence routing, and that the procedures provide adequate training, guidelines, and management oversight provisions.

Procedure 26 – Policy Issuance Procedure

Observations: The Company states all products are guaranteed issue; therefore, there are no issuance procedures. Issuance of policies, regardless of whether the issuance is guaranteed, requires some type of training on the part of the employee/agents.

Recommendations: It is recommended that the Company create a formal written policy issuance procedure.

Procedure 27 – Reinstatement Procedure

Observations: The Company responded that it does not reinstate policies.

Recommendations: None.

Procedure 28 – Insured or Member Requested Claim History Procedure

Observations: The Company provided a brief statement indicating they provide claim histories. The response was deemed unresponsive. For inquiries made by the customer via written correspondence, the Claims examiner will first verify the inquiry is valid, and being made by the insured, by reviewing the information provided by the customer which includes their name, account number, social security number, address, telephone number, etc.

Upon verification of the above information, the Claims examiner prepares a letter to the customer indicating payment history, which includes pay from and pay through dates, and associated dollar amounts. If a request for a copy of the original approval or denial letter is requested, this is sent to the customer.

For inquiries made by the customer via telephone, the Customer Service Representative (CSR) will verify customer name, account number, social security number, address, telephone number, and claim number.

Upon verification of the above information, the CSR may indicate payment or denial information including reading the original correspondence sent to the customer by mail, or honoring their request to re-send the letter.

Recommendations: The Company's response is a narrative of what is supposed to happen under the circumstances of requests for claims histories. The narrative is not a procedure, and contains no controls or means of management feedback. It is recommendation that the Company implement dated and detailed procedures for claim history requests, and that the procedures provide adequate training, guidelines, and management oversight provisions.

Procedure 30 – Premium Determination and Quotation Procedure

Observations: According to the Company, the Actuarial Department does not have written procedures for the calculation of rates. The Company provided a memorandum summarizing the process used by unspecified employees.

The actual procedure used by the Company for determining the premium rates to be used varies by the state in which the rate is to be used and their statutory or regulatory requirements, and the product which is being priced. In general, the first step is to review the statutory requirements of the state in which the filing is to be made. Next, a target loss ratio is determined. This loss ratio is based on the state guidelines. It may be a given value, or it may need to be determined based on the state's criteria. A "claim cost" is then determined. This is usually based on historical data, either internal or external. The premium rate is then determined as the claim cost divided by the target loss ratio.

OR

In general, the Company follows the following process: review the applicable laws and regulations, determine a target loss ratio based upon applicable state guidelines, and determine a "claim cost," which is usually based upon historical data, either internal or external. The premium rate is then calculated as the claim cost divided by the target loss ratio.

R*ecommendations:* None

Procedure 31 – Policyholder Disclosures Procedure

Observations: The Company stated that it does not have any policyholder disclosure procedures.

Recommendations: It is recommended that the Company implement policyholder disclosure procedures that are designed to comply with statutory disclosure requirements contained in state credit insurance laws and regulations.

Procedure 32 – Underwriting and Selection Procedure

Observations: The Company replied that there is no underwriting of its policies because all policies are guaranteed issuance.

R*ecommendations:* None

Procedure 33 – Rate and Form Filing Procedure

Observations: The Company provided a 'review' questionnaire claimed to be used by the policy forms department. The questionnaire is submitted to various departments (i.e., actuarial, claims, finance, sales, etc.) for comments and revisions. The questionnaire was last revised on June 24, 2002. The procedure for policy creation listed the following steps:

- Obtain a description of the program specifics from Marketing.
- Review the program specifics with Actuarial.
- Draft a base policy form.
- Send the form to each functional area in Insurance Services for review and sign-off. Make revisions as necessary.
- Create filing versions for submission to the states. This process includes performing a regulatory review of the laws for each state and modifying the program to conform to those laws.
- Submit the policy and/or certificate to the Department of Insurance for each state in which the Company will file. If changes are required, make modifications to the forms and resubmit.
- Give copies of the approved forms to Implementation.

The procedure for policy revision contained the following steps:

- Perform a regulatory review of the laws for each state and modify the program to conform to those laws.
- Submit the policy and/or certificate to the Department of Insurance for each state in which the Company will file. If changes are required, make modifications to the forms and resubmit.
- Give copies of the approved forms to Implementation.

R*ecommendations:* None

Procedure 34 – Termination Procedure

Observations: The Company stated that termination occurs for nonpayment on the revolving accounts. It is noted that the nature of the insurance is tied to outstanding credit balances, which, if not paid in conjunction with the premium, ends coverage.

R*ecommendations:* None

Procedure 35 – Underwriting File Documentation Procedure

Observations: The Company does not have a formal written underwriting file documentation procedure. As a response to this request (“Underwriting File Documentation Procedure”), the Company replied that there is no underwriting. The Company replied that all policies are guaranteed issuance.

R*ecommendations:* None

Procedure 36 – Underwriting Training Procedure

Observations: The Company does not have a formal written underwriting file documentation procedure. In response to this request ("Underwriting File Documentation Procedure"), the Company replied that there is no underwriting. The Company replied that all policies are guaranteed issuance.

Recommendations: None

Procedure 40 – Staff Training Procedure

Observations: The Company provided a brief statement regarding how they train newly hired employees. Staff training for all employees is provided online via Intranet courses. New Hires are required to take certain courses applicable to their job responsibilities and duties. The online training database provides access to a wide range of training classes and Web Based Training courses. A record of all of the training that the employee has taken is retained.

Each employee is notified via e-mail regarding courses that are required such as Anti-Money Laundering, Privacy & Confidentiality and Security Awareness. Other courses that are made available to employees align with the employee's job, in order that they become more familiar with products and services applicable to their department.

Each individual department has its own training procedures for staff.

Recommendations: It is recommended that the Company implement detailed procedures regarding staff training, and that the procedures provide adequate training, guidelines, and management oversight provisions. The procedures should also be dated so as to track any revisions.

Procedure 42 – Adjuster Training Procedure

Observations: The Company responded that only contracted adjusters are used; therefore, there is no program within the Company for training.

R*ecommendations:* None

Procedure 43 – Claim Handling Procedure

Observations: The Company provided a manual which shows how scanned correspondence, (claim forms) are key-punched into the claims database. It was noted that the Company currently out sources this job function to an India-based company. Very little keypunch is performed in the United States.

No other written procedural policies were provided.

A tour of the Company's claims office was arranged on September 28, 2005. The tour visited three operating areas of the claims office, and the following was noted:

> All correspondence (letters and faxes) are received in the mail distribution room located on the Company's premises in Bridgewater, NJ. The claims call center, which handles only verbal inquiries, is located in New Castle, DE. The call center was not visited.
>
> Once mail is opened or faxes received, the communications labeled as claims are sent to the claims scanning room. The communications are then scanned into the Company database. Most of the scanned communications are sent electronically to India, where the Company maintains keypunch functions, which allocate the scanned information to appropriate policyholders. The product, at this point, is ready for claims adjudication by the Company's claims analysts. After reviewing these communications, claims analysts are given the authority to pay claims, deny claims, or request more information from the claimants.

The Company also described an automated claims adjudication system, implemented within the last year, which purports to perform the claims analysts' decisions without direct human input. Very little written information was provided on this system.

The Company's written documentation of its claims handling procedures was non-existent. At the time of this writing, a third request was made to the Company for documentation of procedures used by various aspects of the claims process.

R*ecommendations:* It is recommended that the Company implement dated and detailed procedures regarding claim handling procedures, and that the procedures provide adequate training, guidelines, and management oversight provisions.

Procedure 44 – Internal Claim Audit Procedure

Observations: The Company provided a brief narrative of the auditing methods for the claims process. While material and objective processes were noted, the narrative itself is not a procedure available in written form to employees and management.

Recommendations: It is recommended that the Company implement dated and detailed procedures for internal claim audits, and that the procedures provide adequate training, guidelines, and management oversight provisions.

Procedure 45 – Claim File Documentation Procedure

Observations: Once the Company receives notice of a claim, the type of policy, applicable limits and other key parameters are confirmed within one business day. All applicable coverage issues are recognized immediately upon receipt of information (first notice, pleading, letter, investigation report, etc.) evidencing the potential coverage issues.

All claimed injuries and damages are evaluated and verified through credible evidence and/or the use of appropriate experts/vendors. File documentation supports the degree of injuries and damages outlined in the case exposure evaluation.

Investigation of facts relevant to coverage issues is initiated after receipt of information evidencing said issue. Investigation is pursued in a proactive manner until all necessary information is obtained. File documentation is required to reflect all coverage investigation efforts.

Circumstances of a claim must support the decision to settle and the reasonable settlement amount. Settlement value must be supported by appropriate file documentation.

R*ecommendations:* None

Procedure 46 – Subrogation and Deductible Reimbursement Procedure

Observations: The Company does not have a formal written subrogation and deductible reimbursement procedure. The Company only sells credit insurance which is not traditionally subject to reimbursement or collateral payment through subrogation or deductibles.

Recommendations: None

Procedure 47 – Reserve Establishment Procedure

Observations: The primary reserves for all lines are case basis reserves for open claims on the Company's software, XyClaim. This system also provides information used to calculate IBNR reserves. Finally, claim triangles are developed from actual paid experience.

The XyClaim system produces three reports used to capture case basis reserve information:

- 753 Report: captures case basis reserves for all open claims (except life) on system. The report allocates the case basis reserves by state and is used for regulatory reporting purposes.
- 754 Report: used to calculate the IBNR reserves. This report captures all claims that exceed a predetermined reporting lag between incurred and reported dates.
- 756 Report: This report is used to report case basis reserves for pending life claims which have been received by not yet paid.

The Company has a detailed process for the following types of reserves: Disability Reserves, Unemployment Reserves, Life Reserves, Property Reserves, and General Ledger Recording

Recommendations: None

SUMMARY

Wesco Insurance Company (Wesco) is a Property and Casualty Company domiciled in Delaware.

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.

Significant issues arising during the course of the examination include:

- Need to improve response time to examiners. (A-09)
- Need to formalize a written procedure for Computer Security (P-4)
- Need to formalize a written procedure for Insurance Information Management (P-10)
- Need to formalize a detailed procedure for Complaint Handling (P-11)
- Need to formalize a control in the Premium Billing Procedure (P-24)
- Need to formalize a written procedure for Correspondence Routing (P-25)
- Need to formalize a written procedure for Policy Issuance (P-26)
- Need to formalize a written procedure for Insured Requested Claim History (P-28)
- Need to formalize a written procedure for Policyholder Disclosures (P-31)
- Need to formalize a written procedure for Staff Training. (P-40)
- Need to formalize a written procedure for Claim Handling (P-43)
- Need to formalize a written procedure for Internal Claim Audit. (P-44)

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

LIST OF RECOMMENDATIONS

Recommendation A-09, The Company cooperates on a timely basis with examiners performing the examinations.
It is recommended that the Company take the needed steps to improve their communication with and response time to the examiners.

Recommendation P-4, Computer Security Procedure
It is recommended that the Company create a written computer security procedure that clearly displays management review and control, and testing procedures.

Recommendation P-10, Insurance Information Management Procedure
It is recommended that the Company create a written computer security procedure that clearly displays management review and control, and testing procedures

Recommendation P-11, Complaint Handling Procedure
No time constraints were noted on the required complaint handling procedures. The procedures themselves are considered adequate, however, because of the time-sensitive nature of this type of insurance primarily designed to pay the debts of the insured, it is recommended that the Company's complaint procedures incorporate time limits. It is also recommended that the Company date their procedures in order to track relevance of the procedures as compared to NAIC and state regulatory mandates and guidelines.

Recommendation P-24, Premium Billing Procedure
The narrative regarding premium billing provided by the Company showed no measurement structure, management oversight, or management control. It is recommended that the Company incorporate controls into the premium billing procedure.

Recommendation P-25, Correspondence Routing Procedure
It is recommended that the Company implement dated and detailed procedures for correspondence routing, and that the procedures provide adequate training, guidelines, and management oversight provisions.

Recommendation P-26, Policy Issuance Procedure
It is recommended that the Company create a formal written policy issuance procedure.

Recommendation P-28, Insured Requested Claim History Procedure
The Company's response is a narrative of what is supposed to happen under the circumstances of requests for claims histories. The narrative is not a procedure, and contains no controls or means of management feedback. It is recommendation that the Company implement dated and detailed procedures for claim history requests, and that the procedures provide adequate training, guidelines, and management oversight provisions.

Recommendation P-31, Policyholder Disclosures Procedure
It is recommended that the Company implement policyholder disclosure procedures that are designed to control statutory disclosure requirements mandated under state credit insurance laws and regulations.

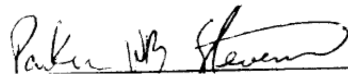
Recommendation P-40, Staff Training Procedure
It is recommended that the Company implement dated and detailed procedures regarding staff training, and that the procedures provide adequate training, guidelines, and management oversight provisions.

Recommendation P-43, Claim Handling Procedure
It is recommended that the Company implement dated and detailed procedures regarding claim handling procedures, and that the procedures provide adequate training, guidelines, and management oversight provisions.

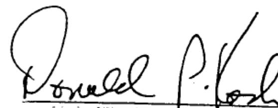
Recommendation P-44, Internal Claim Audit Procedure
It is recommended that the Company implement dated and detailed procedures for internal claim audits, and that the procedures provide adequate training, guidelines, and management oversight provisions.

CONCLUSION

The examination was conducted by Donald P. Koch, Parker W.B. Stevens, and Peter Schaeffer, and is respectfully submitted,



Parker Stevens, FLMI, AIRC, CIE
Market Conduct Examiner-in-Charge
Insurance Department
State of Delaware



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Market Conduct Supervising Examiner
Insurance Department
State of Delaware