

**MARKET CONDUCT EXAMINATION
OF
ST PAUL SURPLUS LINES INSURANCE COMPANY
AS OF
NOVEMBER 11, 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 NOVEMBER 11, 2005 of the

ST. PAUL SURPLUS LINES INSURANCE COMPANY

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

ATTEST BY:

Antoinette Handy

DATE: 28 MAY 2008

In Witness Whereof, I HAVE HEREUNTO SET MY HAND
AND AFFIXED THE OFFICIAL SEAL OF THIS
DEPARTMENT AT THE CITY OF DOVER, THIS
28TH DAY OF MAY, 2008.



Matthew Denn

Insurance Commissioner

**REPORT ON MARKET CONDUCT EXAMINATION
OF THE
ST. PAUL SURPLUS LINES INSURANCE COMPANY
AS OF
NOVEMBER 11, 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 28TH day of MAY, 2008.

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SALUTATION

April 4, 2007

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 05.783, and pursuant to statutory provisions including 18 Del. C. §318-322, a Market Conduct Examination has been conducted of the affairs and practices of:

St Paul Surplus Lines Insurance Company

The examination was performed as of November 11, 2005. St. Paul Surplus Lines, hereinafter referred to as the "Company" or as "St Paul," is incorporated under the laws of the State of Delaware. This examination consists of two phases, an on-site phase and an off-site phase. The on-site phase of the examination was conducted at the following Company location:

- 385 Washington Street, Saint Paul, MN

The off-site examination phase was performed at the offices of the Delaware Department of Insurance, hereinafter referred to as the "Department" or as "DDOI," and other suitable locations.

This report of examination thereon is respectfully submitted.

SCOPE OF EXAMINATION

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

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

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

The second component is an analysis of the management of the various business areas subject to a Market Conduct Examination through a review of the written procedures of the Company. This includes an analysis of how the Company communicates its instructions and intentions to its lower echelons, how it measures and monitors the results of those communications, and how it reacts to and modifies its communications based on the resulting findings of the measurement and monitoring activities. The examiners also determine whether or not 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 there may be areas tested and described for which an exception has not been noted, but the description is included in the report, despite a lack of recommendation. Substantial departure from the norm may result in a supplemental review focused on the area so noted.

HISTORY AND PROFILE

St Paul Surplus Lines Insurance Company was incorporated on February 22, 1974, as St. Paul Surplus Lines Insurance Company, a stock insurer, under General Corporation Law of the State of Delaware. Business was commenced May 31, 1974. The Charter provided for a perpetual term of existence.

St. Paul Surplus Lines Insurance Company is a subsidiary of St. Paul Specialty Underwriting, Inc., which is in turn a direct, wholly-owned subsidiary of St. Paul Fire and Marine Insurance Company (a direct, wholly-owned subsidiary of The St. Paul Travelers Companies, Inc.). On April 1, 2004, The St. Paul Companies merged with Travelers Property Casualty Corp. and is now known as The St. Paul Travelers Companies, Inc.

As a specialty carrier, the Company continued underwriting operations nearly exclusively to the writing of excess and surplus lines of insurance. The Company's Certificate of Authority, however, authorizes the transaction of business health, credit health, property, marine and transportation, and casualty for the following lines: vehicle, liability, burglary and theft, personal property floater, glass, boiler and machinery, credit, leakage and fire extinguisher equipment, malpractice, elevator, congenital defect, livestock, entertainments' surety and workers' compensation, employer's liability and miscellaneous.

METHODOLOGY

This examination is based on the Standards and Tests for a Market Conduct Examination found in Chapter XVII of the Delaware Market Conduct Examiners' Handbook. This chapter is derived from applicable Delaware Statutes, Rules and Regulations as referenced herein and the *NAIC's Market Conduct Examiners' Handbook*.

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

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

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

An "electronic" review indicates that a Standard was tested through use of a computer program or routine applied to a download of computer records of the examinee. This type of review typically reviews one hundred percent (100%) of the records of a particular type.

Standards are measured using tests designed to adequately determine how the examinee met the standard. Each Standard applied is described and the result of testing is provided under the appropriate Standard. The Standard, its statutory authority under Delaware law, and its source in the *NAIC's Market Conduct Examiners' Handbook* are provided.

Each Standard contains a brief description of the purpose or reason for the Standard. The "Result" is indicated and the examiners' "Observations" are noted. In some cases a "Recommendation" is made.

A. COMPANY OPERATIONS/MANAGEMENT

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

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

Standard A 08

NAIC's Market Conduct Examiners' Handbook - Chapter VIII §A, Standard 8

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

18 Del. C. §318(a), §505(b), §508(b)

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

Result: Pass

Observation: The Company is authorized to write surplus lines coverage.

Recommendation: None

Standard A 09

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

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

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

The review methodology for this Standard is “generic.” This Standard has a direct insurance statutory requirement. This Standard is intended to ensure that the Company is cooperating with the state in the completion of an open and cogent review of the Company’s operations. Cooperation with the examiners in the conduct of an examination

is not only required by statute, it is conducive to completing the examination in a timely manner and thereby minimizing costs.

Result: Fail

Observation: When the Company was first notified of this examination, they requested an immediate postponement. The Company explained that they were being audited by an unusually high number of auditors at the same time, and resources were stretched. In response the examination was postponed for several months. Upon the start of the examination, the Company informed the examiners that there continued to be several concurrent examinations running, and as such, their personnel would be attempting to respond to all audits as efficiently as possible. In response, this examination extended the standard expected response time for requests from three business day to five business days.

Despite the above concessions, during the course of the examination, there were considerable delays in the company's responses to informational requests. Delays of this type increase the examination's time and cost, and should be avoided as much as possible, in the future.

Recommendation: It is recommended that the Company develop a procedural action plan to facilitate examinations, in accordance with 18 Del. C. §320(c).

B. COMPLAINTS/GRIEVANCES

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

The Company provided a database with forty-one (41) logged complaints for the almost four years [January 1, 2002 – November 3, 2005] that comprised the scope of the examination. All complaints from the master log were reviewed to look for any distinguishable complaint patterns. The database format and the information contained within the database do comply with 18 Del. C. §2304(17).

Recommendation: 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 an 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 – Internal and External Audit

Observations: The Company maintains an Internal and External Audit Procedure under the direction of the Parent Company and guided by an audit charter. The Internal Audit function is based upon a business unit's (or business entity, as referred to by the Company) risk analysis performed by the Parent Company's Corporate Audit Team (CAT). The CAT is to assess a business entity's risks, in conjunction with the Company's external auditor's (KPMG) findings, and establish risk identifiers in determining the focus areas for an audit. Each business entity and business function, *e.g.*, Claims, is to conduct quarterly risk meetings to review results based upon the entity's audit. The entity audits, along with the external auditor's findings, are to be reported to the CAT for their use when planning the internal audit schedule.

As mentioned above, the Company's CAT utilizes part of the work performed by the external auditors in determining risk. However, according to the Company, the external auditors have not performed any reviews related to the Company covering the scope of this examination. Additionally, the Parent Company's CAT has not performed a Company specific internal audit prior to the 2004 merger, however, the Company's business entities have been subject to internal audit reviews covering the scope of the examination.

The CAT reviews an entity as a whole and does not divide their review between the admitted and non-admitted aspects of an entity. The Company continuously updates its risk assessment from various sources. During the quarterly meetings audit results are presented and the status of corrective actions are discussed, with this information

eventually presented to senior management and the Audit Committee. Follow-up action plans are developed as a result of these quarterly meetings. The presentations prepared by Corporate Audit adequately document the content of these discussions.

The Company stated that examination audits are occurring but that these audits cover a timeframe that is outside the scope of the present examination therefore no information is available for the examiners to review at this time.

Recommendation: None

Procedure 05 – Anti-Fraud

Observations: The Company's Anti-Fraud Procedures are designed to identify fraudulent claims and control internal resources. Direction for identifying possible fraudulent claims is maintained through a set of procedures entitled, *Guidelines to Handling Suspicious Claims* (GHSC). The GHSC provides details for claim adjustors on how to identify and refer suspicious claims, investigation suggestions, management responsibilities and training. The Company's Parent Company has established a corporate-wide Internal Investigations Department (IID). The IID is designed to investigate any alleged or suspected fraud, waste or abuse by employees, agents or vendors of the Company. The IID may be alerted to possible abuse cases through a dedicated telephone hotline listed within the employees' Code of Ethics handbook.

The claims adjustors assigned to review claims suspected of fraud are referred to as the Special Investigations Unit (SIU). The SIU groups are based regionally and overseen by a regional manager. In order to determine compliance with the GHSC, a local quality manager and the regional manager perform a monthly quality review on a select number of SIU adjustor files. The IID has developed software applications to use for data mining. According to the Company, the IID data mining applications are also programmed to allow the Company to search for variables to detect fraudulent activity within internal systems or to ensure vendor credentials as well as to detect possible internal collusion with outside entities.

Management uses the quality reviews to determine SIU effectiveness and deficiencies. SIU measurement results can be compared individually or globally in determining areas, which may require additional training. According to the Company, the aggregate of all SIU reviews are to be reported to senior management and provided to Corporate Audit (see Procedure 01 Internal and External Audit). Additionally, senior management utilizes provisions of Sarbanes-Oxley (SOX) to support its Anti-Fraud efforts.

Recommendation: None

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

Observations: As part of their business operations the Company utilizes Managing General Agents (MGA) and Third Party Administrators (TPA) in performing

underwriting and policy issuance on the Company's behalf. The Company refers to their MGA/TPA as Managing General Underwriters (MGUs). Additionally, the Company grants certain brokers Underwriting Authority (UA). The UA allows brokers the ability to underwrite, yet the final binding decision remains with the Company.

Prior to an MGU and/or broker with UA providing services on the Company's behalf, contracts are agreed to and authority limits established. Contract provisions and authority limits become the basis for mitigating MGU and UA control. Each of the Company's business entities have established timeframes for performing MGU and UA reviews in part to comply with Sarbanes-Oxley (SOX). As part of the Company's SOX compliance a review of its business entities - MGUs and brokers with UA – is conducted on an annual basis and larger MGUs with regional offices are reviewed at least every eighteen (18) months.

The MGU and UA audits performed by the business entities are similar in nature, in that they both provide the audit background, process, results and summaries when files are noted as unsatisfactory and need improvement, and they both include final comments. Each business entity [except for (E&S)] requires a response within a specific timeframe when files or processes are identified as unsatisfactory. However, evidence of unsatisfactory responses by an MGU or UA is not evident or included as part of the audit reports.

Recommendation: It is recommended that the Company establish follow-up procedures for all audit reports of MGUs and UAs. These procedures should ensure that any issues considered "unsatisfactory" are addressed and resolved.

Procedure 09 – Customer and Consumer Privacy Protection

Observations: The Company has a Privacy Protection Procedure. The Company provided the following statement; "*In accordance with applicable law, St. Paul Travelers will maintain physical, electronic and procedural safeguards to protect personal information about its customers in its records. All employees who handle personal information pertaining to Personal Lines Insurance customers will treat such information as confidential.*"

The parent company's Code of Business Conduct and Ethics, which applies to the Company, states:

If you become aware of any existing or potential violation of any law, regulation or this Code of Conduct, you must notify the Chief Compliance Officer. You may contact the Chief Compliance Officer directly or you may provide notification by calling the Ethics Helpline in the U.S. or Canada at 800/978-7285. Employees calling from a country other than the U.S. or Canada may call the Ethics Helpline collect (toll-free) at 770/582-5270. You may request that any concern you report be treated confidentially and anonymously.

Upon request by the examiners the Company provided additional information related to privacy protection regarding claim handling. The Company maintains an electronic claim system which allows for sensitive information to be noted as such and stored separately. The Company's claim privacy processes require information marked as privileged to be considered "attorney/client" material.

Recommendation: None

Procedure 10 – Production of Business

Observations: The Company's Production of Business process is generated through the non-admitted surplus lines market. Applications for requested coverage are submitted through both contracted and warehouse or "clearinghouse" brokers. All brokers are to be contracted with the Company prior to the business being placed.

According to information provided by the Company limited interaction occurs between the brokers and the Company. To attract brokers the Company will offer information on business units and the coverages offered (refer to Procedure 13), supply A.M. Best ratings, and identify the Company's inclusion within the St. Paul Travelers Group.

Recommendation: None

Procedure 11 – Complaint Handling

Observations: The Company stated that its Complaint Handling Procedures for both written and verbal (telephone) complaints are under the control of the Parent Company's Consumer Affairs (CA) division. Procedures identify the establishment of initial contact, locating the department best able to answer/resolve the complaint, response timeframes and a means to track open complaints through a dedicated Consumer Affairs Tracking System database, referred to as CATS. The Company's procedures reference response timeframes: twenty four (24) hours for verbal complaints, seven (7) business days for written complaints and state insurance department complaints are to be handled within the specified time period contained in the response instructions. However, the procedures do not address the CA's responsibilities for on-going communication when the complaint cannot be resolved within the specified timeframes.

A review of complaint files was performed under Standard B-1 of this examination and during that review it was noted that the complaint database contained errors. The Company's processes require a monthly accuracy review of the complaint database. According to the Company the types of errors noted were due, in part, to a legacy complaint database in use prior to the Company's 2004 merger. The current matrices now prevent the errors noted and further ensure data accuracy. A Consumer Affairs Project Specialist reviews the complaint file database to ensure data accuracy, internal procedural compliance and to monitor issue resolution.

Information taken from the Company's monthly complaint reports is included as part of the Parent Company's quarterly complaint trending reports prepared by a CA manager. According to the Company, their trending of aggregate complaint results does not require a management response due to the limited number of annual complaints, *e.g.*, twelve (12) complaints received in 2005.

Recommendation: None

Procedure 13 – Advertising, Sales and Marketing

Observations: The Company provides brokers with "sell sheets" which contain information regarding product line specifications. Each of the Company's business entities develop and produce their own sell sheets. Each of the business units maintain all supporting documentation related to its own sell sheet development.

Review of the sell sheets occurs internally within the business entity, followed by a review by the Corporate Communication Staff and finally a Legal review. A review of sell sheet sign offs from two (2) business entities were selected to confirm the review/sign off process. The Company was unable to provide sign offs for both of the sell sheets selected. The Company has indicated that the sell sheet which could not be provided was misplaced and is no longer in use.

Recommendation: None

Procedure 14 – Agent Produced Advertising

Observations: When the Company contracts with a surplus lines broker, the broker's contract contains a provision regarding Broker Produced Advertising. According to the contracts provided by the Company a broker must receive prior approval to utilize the Company's name in any advertising materials.

A surplus lines broker's failure to abide by the contract's provisions and/or utilizing the Company's name without express written approval may lead to immediate contract termination. According to the Company, during the scope of this current examination one (1) broker was identified as failing to obtain approval in using the Company's name and was subsequently reminded of the broker's contract provisions regarding advertising.

The Company relies upon its contract provisions to prevent the unauthorized use of their name by brokers. The Company does not inquire about or focus resources on identifying brokers in violation of the broker contract. The above mentioned occurrence was identified through routine correspondence with the broker in question, who had included the Company's name as part of an electronic communication.

Recommendation: None

Procedure 15 – Producer Training

Observations: The Company does not maintain procedures for Producer/Broker Training. The Company's business is placed through surplus lines brokers. Inherent within most of the surplus lines broker processes are submissions of non-admitted business sent to multiple carriers in a "clearinghouse" format. The Company supplies "sell sheets" for informational purposes to assist the brokers in properly identifying "clearinghouse" coverage options.

The Company does utilize brokers with underwriting authority, which are referred to as Managing General Underwriters (MGU) by the Company. The Company's processes relating to MGU training can be summarized by the following comment from the Company: "St. Paul Surplus Lines does not train producers, with producers defined in the narrowest form. We train underwriters on our products that are employed by brokers, MGU's, etc."

Recommendation: None

Procedure 20 – Producer Selection, Appointment and Termination

Observations: The Company maintains a broker licensing process. All brokers attempting to initially place business with the Company are required to meet specific requirements set by the Company, complete an application and agree to the contents of the broker Agreement to Contract. The broker agreement includes evidence of the broker's current surplus lines license and Errors and Omission (E&O) coverage. Once a broker is approved, broker information is loaded into a policy issuance database. Prior to a policy being issued internal checks are performed to ensure the broker has prior approval. According to the Company, control measures will not allow a policy to be issued when a broker is not approved within the database.

Reviews of broker activity appear limited once a broker has been established with the Company. The Company uses broker reviews as a tool to terminate broker contracts due to low premium volume production. Contracts allow both the Company and the broker to terminate the contract without cause provided proper notification is given. Evidence of concurrent licensing records and in-force E&O coverage are not reviewed once a broker is established with the Company.

Recommendation: It is recommended that the Company develop measurements and perform reviews at regular intervals to ensure surplus lines brokers' licenses remain in good standing.

Procedure 21 – Producer Defalcation

Observations: The Company maintains a Producer Defalcation process enacted through the contract between the Company and their surplus lines brokers. The contract between the Company and their brokers details the reporting and fiduciary responsibilities of each

party. Monthly remittance reports are prepared by either the broker or the broker may elect to have the Company prepare their monthly report. Account reviews are performed monthly for all current accounts. In the event an account becomes past due the Company will perform interim reviews in an attempt to bring an account back to current. The Company, via their contract, is allowed access to other legal options in order to collect on past due accounts. In the event the Company seeks reimbursement via these legal options and the insured is able to document that premiums were paid to a broker, all coverage will remain effective and the insured's premiums transferred to direct bill.

Recommendation: None

Procedure 22 – Prevention of Use of Persons with Felony Conviction

Observations: The Company does not have a formal written procedure regarding the Prevention of Use of Persons with a Felony Conviction. The processes in place by the Company for Felony Prevention are separated by broker controls and new employee hiring practices. As a non-admitted writer the Company maintains the following stance on broker background reviews: "surplus lines brokers are not appointed, therefore, background checks are not required." Each new employee is, however, required to undergo background checks by the Company's Pre-employment Screening Unit (PESU). The PESU consists of employee investigators who complete background checks on external hires.

Once the background checks are complete, employees are to abide by the Company's *St. Paul Travelers Code of Business Conduct and Ethics Manual*. The only felony prevention control after the PESU is the following excerpt from the *St. Paul Travelers Code of Business Conduct and Ethics Manual*: "Any employee who is or has ever been convicted of a crime involving dishonesty or breach of trust must promptly report the conviction to the Chief Compliance Officer." It is the examiners conclusion that the Company's process is too reactive in guaranteeing that the Company does not retain any employees who have been convicted of a felony after the employee has been hired. While requiring an individual to report any conviction to the Chief Compliance Officer there is no written policy/procedure addressing any consequences to the employee for not reporting the conviction.

Recommendation: It is recommended that the Company's Employee handbook include a provision to perform periodic background checks of employees throughout their tenure to ensure compliance with 18 U.S.C.A. §1033.

Procedure 25 – Correspondence Routing

Observations: The parent company provided information related to their Correspondence Routing processes. All written correspondence addressed to the Hartford, CT, and St. Paul, MN, offices are received and sorted by the parent company's two mailrooms in these locations. Both facilities have the ability to sort mail, either electronically or manually, or to use a key word directory to locate the correct individual to receive the correspondence. In the event the recipient cannot be identified the mailroom will contact

the sender. Additionally, the parent company processes direct all internet correspondence and complaints from a State Department of Insurance to the Consumer Affairs Department of the Company. Consumer Affairs is then responsible for forwarding emails to the proper individual within the Company. If an incoming fax or e-mail is misdirected, processes include efforts to redirect the correspondence to the correct individual and/or business area for any necessary action.

The mailroom management addresses the tracking of mishandled mail. The Company's mailroom operation tracks the volume of incoming and outgoing mail. According to the Company the Mail Operations Director develops a monthly report for the Senior Director of Mail Operations that details the volume of mail sent and received.

Recommendation: It is recommended that the Company formulate and adopt a written Correspondence Routing Procedure based upon the internal processes already in place.

Procedure 26 – Policy Issuance

Observations: The Company's Policy Issuance Procedure is mostly housed within a web based policy printing application called DSF. All business units with the exception of one Managing General Underwriter (MGU) utilize DSF. According to the Company, the one MGU is under consideration for being added to DSF for policy issuance. Functionality within DSF will allow an underwriter not only the ability to issue new policies, but also to attach endorsements, and process renewals, policy extensions and policy reprints.

Company underwriters and their assistants enter policy related information into DSF. The types of information selected within DSF vary by line of business, but may include items such as, state specific forms and policy specific exclusions. Once all the policy information has been entered and the appropriate forms selected, the underwriting staff sends the policy to be printed. The underwriter and their assistants review all policies prior to the policy being sent to the surplus lines broker for delivery.

The DSF application is a “dumb” system which will allow for user error, in that the underwriting staff could select incorrect forms for the policy type selected and DSF does not identify the selection as an incorrect form. Errors not identified by the underwriting staff prior to the mailing of the insurance contract may lead to inadvertent underwriting statutory violations. Company management performs underwriting reviews of both Company underwriting files and those bound on the Company's behalf by MGUs. Reviews of both Company underwriting files and MGU files identified the use of incorrect forms and/or exclusions.

Recommendation: It is recommended that the Company review its procedures for detecting policy issuance and improper form usage errors and ensure that these errors are communicated to the underwriting staff in order to prevent their recurrence.

Procedure 27 – Reinstatement

Observations: The Company does not maintain a Reinstatement Procedure. The processes that are in place address the handling of a policy should non-payment of premium occur. The Company stated the following: "Except in the case of non-payment of premium, it is rare that a P&C policy is reinstated after it has been cancelled. In the case of a non-payment of premium cancellation of a policy that's been financed through a finance company, the finance company processes the reinstatement notice. No formal written procedure is warranted." Company processes also allow for policies to be re-issued instead of reinstated.

According to the Company, the effectiveness of the reinstatement process is measured through self-audits and MGU audits. The examiners reviewed audit reports for the inclusion of reinstatements. When reinstatements were not evident within the audit reports a request for the reinstatement audit criteria was requested. The Company provided the following response: "reinstatements are rare and it would require extra programming costs to identify policies for an audit that have been cancelled and reinstated. We're not willing to incur such extra expenses for an extremely uncommon occurrence. UW auditors are fully aware of the practices described above and should they happen to run across an UW file that was cancelled and reinstated, the expectation is that they will note whether the appropriate practice was or was not followed."

Recommendation: None

Procedure 28 – Insured or Member Requested Claim History

Observations: The Company does not maintain a written Insured Requested Claim History Procedure. According to the documentation provided by the Company the process for a request of this nature would be routed to the underwriter of the business unit who underwrote the account or claim handler associated with the insured. Not all business units maintain processes for handling a loss history request and it is the responsibility of each business unit head to do so. The entities with loss reporting processes have a response goal of two to five working days. According to the Company "a response to any such request is made immediately to the named insured or their authorized representative."

The Company operates without a documented process for responding to loss history requests. As such, measuring the consistency of the Company's response to claim history requests is difficult. Additionally, the review of both self-audits and MGU audit criteria and the subsequent reports lack a component for loss histories requests.

Recommendation: It is recommended that the Company formulate and document a process for responding to an insured's request for their claims history.

Procedure 30 – Premium Determination and Quotation

Observations: In order to provide a quote all business units require completed applications and/or require insurance specifications that describe the coverages being requested and must be accompanied with the necessary underwriting information. A broker will submit an account to an underwriter who determines if the risk meets the Company's underwriting criteria. If it does, a quote is issued to the broker and a copy maintained in the underwriter's files. While not under any obligation to provide every broker with a quote for every risk submitted, the Company will work with a broker to provide a response to a request for a quote.

Recommendation: None

Procedure 31 – Policyholder Disclosures

Observations: The Company's Policyholder Disclosure processes are based in part on each of the states' disclosure requirements and the disclosure responsibilities of the surplus lines broker. The Company maintains within its underwriting documentation the disclosures required for each policy type issued by their business entities. During the policy assembly process the underwriter and their technical assistant are required to double check each policy for the proper disclosures prior to submitting the policy to the broker.

The Company's disclosure responsibility in selecting and providing the appropriate disclosures are detailed in Procedure 26 - Policy Issuance. Once the policy is delivered to the surplus lines broker the Company no longer maintains any further disclosure control. The surplus lines broker is required to attach any and all final disclosures to the insured's policy prior to its delivery.

Recommendation: None

Procedure 32 – Underwriting and Selection

Observations: The Company does not provide each business unit centralized Underwriting and Selection Procedures. The Company's business entities' writings vary and for proper risk selection each entity has developed its own underwriting guidelines. In determining risk classifications, the business entities require completed entity and line of business specific applications. Additionally, based upon the coverages sought, the underwriting guidelines may require multiple supplemental applications before the entity's underwriting staff can fully evaluate the risk.

The Company's underwriters and the MGU underwriters perform the Underwriting and Selection. The MGUs are contracted with binding authority and in use by most of the Company's entities. Many of the underwriting guidelines have been specifically developed for an MGU, which includes risk selection controls. Company underwriters are similarly limited in binding coverage through the use of individual underwriter authority limits.

The Company has identified Underwriting and Selection controls for both Company and MGU underwriters. Concurrent reviews of Company underwriters occur monthly with MGU reviews occurring at least annually. Reviews include underwriting file documentation as well as determinations made for proper risk selections. The reports provided by the Company indicate errors in underwriting selection. It should be further noted that many of the reports provided addressed prior audit concerns.

Recommendation: It is recommended that the Company develop appropriate remediation action plans to address recurring errors discovered through Company and MGU audit reviews.

Procedure 34 – Terminations

Observations: The Company does not maintain written Termination/Cancellation (Termination) Procedures. The processes in place were described by the Company through a single sample of policy termination language, the use of Odens state regulation database and the use of ISO based definitions. The following policy language was noted from a sampled policy, "*We can cancel all or part of your policy at any time before your policies (sic) expiration date.*" According to the Company's processes an underwriter makes the termination decision. Once the termination decision is made the underwriter references Odens for applicable state termination/cancellation/non-renewal laws and regulations.

According to information from the Company, the oversight of the Termination process is to be noted during self-audits and MGU audits. Upon request the Company could not identify evidence of Termination testing criteria.

Recommendation: It is recommended that the Company develop clearly defined testing criteria for Terminations and Cancellations when self-audits and MGU audits are performed.

Procedure 35 – Underwriting File Documentation

Observations: The Company's Underwriting File Documentation processes are decentralized to the business entity level. Each business entity maintains underwriting file documentation procedures representative of the lines of business being produced. The business entities' procedures allow underwriters to determine the information necessary to underwrite the file while describing minimum standard requirements.

The Company's business entity Underwriting File Documentation Procedures apply to both in-house Company underwriters and the contracted MGUs. Each entity requires annual underwriting file reviews. The procedures dictate the frequency of the reviews, the number of files to review (both renewals and new issue files), and how to record and report review findings.

The type of information reported from the underwriting reviews varies in detail based upon the entity. However, each report records items whereby the review team identifies

whether standards are being met or if any issues are noted with recommendations. Additionally, within each entity's Underwriting File Documentation procedures there are directives designed to address the Company's expectation of the development of a remediation plan in response to findings and/or recommendations. The review of underwriting reports shows that recommendations are repeated from annual reviews to the quarterly follow-up reviews. This indicates that procedural remediations are not consistently applied.

Recommendation: It is recommended that the Company activate the remediation processes identified within its Underwriting File Documentation Procedures. It is recommended that the Company continually measure and reassess business entities until remediation plans have met the Company's own compliance standards.

Procedure 36 – Underwriter Training

Observations: The Company does not maintain an Underwriter Training Procedure or have established continuing education requirements for underwriters. The Company's approach to the Underwriter Training process is evidenced by the following Company response: "We hire experienced support staff typically with admitted company experience. Training in surplus lines is done OTJ by business units along with foundational resource materials such as the Surplus Lines COE Q&A and related documents." The two documents referenced in the Company's response provide general information differentiating between the admitted and non-admitted markets.

Recommendation: It is recommended that the Company develop continuing education requirements for Underwriters and a process for monitoring compliance with the requirements.

Procedure 40 – Staff Training

Observations: The Company does not maintain Staff Training Procedures for all business lines and operational business functions. In addition the Company does not have established continuing education requirements for Staff. Staffing resources for operational functions are shared by both the Company's entities and with pooled companies. The Company provides general information regarding the non-admitted market to assist staff with shared responsibilities. For additional information pertaining to Underwriting Training and Adjuster Training please refer to Procedure 36 and Procedure 42 respectively.

The foundation of the Company's training documentation is a manual for the Company's policy issuance program utilized by the underwriting staff. Outside of the policy issuance application manual the Company stated, "We hire experienced support staff typically with admitted company experience. Training in surplus lines is done on the job (OJT)."

According to information provided by the Company, staff training is the responsibility of the business unit head. Failing to maintain staff training processes and procedures creates inconsistencies in the execution of business activities affecting regulatory compliance.

Recommendation: It is recommended that the Company develop continuing education requirements for staff as appropriate and a process for monitoring compliance with the requirements.

Procedure 42 – Adjuster Training

Observations: The Company has a procedure for Claim Adjustor Training. Training is specifically performed through the Company's Claims University. The Claims University organizes training sessions throughout the year in multiple locations. Depending on the line of business the Company will provide a development plan to meet training goals for each adjustor. The Company's practice is to hire individuals with prior experience within the field of employment. Current employees can enroll voluntarily for training sessions with the prior approval of a training supervisor. The Company also has staff periodically attend various conferences and seminars for continuing education.

The effectiveness of the training sessions is measured through the testing of the attendees' retention and application of knowledge. The individual participant must earn above an eighty percent (80%) to pass each test of knowledge retention. Grades are provided to the hiring manager or, for existing employees, to the direct supervisor. Upon completion of each training session the participants are provided an evaluation to complete which is reviewed and adjustments to both content and method of delivery of training classes are made based on the evaluations. Additionally, for selected courses a six (6) month post program review is performed. The review of the participant's work product as well as interviews with both the participant and direct supervisor is performed. Based on this follow up review, additional changes, if needed, are made to content and delivery of the training classes.

Recommendation: None

Procedure 43 – Claim Handling

Observations: The Company does not maintain a centralized set of procedures for Claim Handling. Rather, the Company utilizes claim handling guidelines and a 'best practices' process for all applicable lines of business. The information provided contains a "broad overview" of perspective versus written step-by-step instructions for employees. According to the Company, given the uniqueness of surplus lines this process allows for individual claim handlers to better address each states' requirements. Further, the Company maintains that, "... if procedures are written narrowly and too detailed ... they simply become too long, unwieldy and burdensome to use. Every claim needs to be analyzed on a case by case basis. All claim handlers are instructed, in the 'best practices' document, to refer to the laws of the [particular] jurisdiction, including claims handling statutes, for further guidance on handling the unique facts of their cases."

The claim handling documents provided by the Company did not reference response time requirements when discussing claim settlement timeframes. For state specific standards, the employee was directed to make contact with an outside vendor or “claims counselor,” for assistance. During the examination, however, the Company explained that its ‘best practices’ document was updated. This document now states that the Company’s Claims database contains the specific state timeliness requirements as well as other requirements/directions for the handling of claims.

Also, the claim handling processes presented by the Company did not contain a requirement for the date stamping of all incoming claim related communications. According to the Company, updates to its claim handling procedures were being prepared during the examination and now include multiple sections relating to the importance of date stamping claim related information.

The Company measures the effectiveness of their claim handling processes through what is referred to as “calibration” and “validation.” “Calibration” is the process of ensuring that all file reviewers are consistent in applying review standards. “Validation” is to ensure that the review information meets expectations. “Validations” are performed monthly by claims department unit managers and by national Quality Management Teams during the self-audit and national audit processes. Evidence of validation and calibration appeared in several documents summarizing claim file reviews on the self-audit and national audit levels. These self-audits and national reviews are the basis for the Company’s internal claim audit process. (Please refer to Procedure 44).

The Quality Management Team (QMT) is comprised of claim examiners who perform and analyze four (4) different levels of claim review, provide feedback to unit managers based upon the file reviews and create action plans to correct any negative reviews. The QMT uses an application referred to as “Quality Management,” a database used to report the annual claim office review results to senior management. The Quality Management application (QMA) is comprised of the aggregate of the claims review data collected from the four (4) levels of claim reviews and the action plans when review results are outside of the calibration and validation guidelines. The QMT produces a report following each office’s annual review, which is then distributed to the senior management of each regional and home office. According to information provided by the Company, the Corporate Audit division then reviews and follows-up on the action plans contained within the QMA database.

Recommendation: None

Procedure 44 – Internal Claim Audit

Observations: The Company relies upon the Internal Claim Audit process below for all claim types (with exceptions described below). The process consists of four levels of review:

- Claim Unit manager review
- Claim Center validation review
- National Validation
- National Quality Management review

The number of files reviewed varies by the line of business with the review levels. Additionally, claim files may also be reviewed when Corporate Audit periodically reviews any claim activities.

Monthly Claim Unit Manager Review

Each Claim unit manager reviews files for each adjuster assigned to the unit. These reviews are primarily used to provide Claim managers with a consistent method of evaluating each adjuster's development and performance. Managers document the results of reviews and follow up on any corrective actions for the file with individual adjusters.

Corrective actions may be retrospective and prospective or prospective only. For example, if a file review determined that the adjuster did not pay the appropriate sales tax in the claim settlement, the manager would follow-up to ensure the adjuster issued a supplemental payment for that file. For future monthly reviews, the manager monitors the adjuster for this for future claims. These follow-ups continue until it is determined the issue has been satisfactorily resolved or additional management action is warranted. To continue the example, if an individual file review concludes that an adjuster did not make contact within the legally required timeframe after a claim was presented, the only corrective action available is prospective. Again, the issue would be monitored in future monthly reviews.

Because this is primarily a management tool, follow-ups for individual issues are generally verbal. However, if the issue involves concerns with the adjuster's development or performance, the manager may follow-up in writing.

Quarterly Validation Review

For most lines of business, a field product line manager quarterly reviews and validates one file for each claim unit manager. Some claims for specialty lines of business, such as Professional Liability and Ocean Marine claims are also reviewed quarterly, but peer managers conduct these types of reviews to verify that consistent and thorough reviews are being completed.

Annual National Claim Center Validation

The Claim Quality Management (QM) Department annually reviews files pulled from the pool of files completed by unit managers.

Annual National Quality Management Review

QM also reviews eighty (80) random files covering the entire business entity.

The process continues with a report being issued after the two National reviews are conducted. The report summarizes the findings of the current reviews, documents any previous issues that were not adequately addressed, and identifies new trends. Claim executive management, including the local Claim Center Vice President and Field Vice Presidents responsible for the individual office, and Claim executives responsible for an entire line of business receive the report. The examiners reviewed portions of these reports.

In the report, QM makes recommendations to Claim executives based upon three validation ratings (satisfactory, needs improvement, and unsatisfactory) which consider the operating condition (*i.e.*, compliance with established best practices, policies and processes) of the entity during the period covered by the review and the materiality of the issues. A corrective action plan is required for any rating of ‘needs improvement’ or ‘unsatisfactory.’ Action plans developed during the annual reviews are followed-up on during the quarterly validation reviews.

Recommendation: None

Procedure 45 – Claim File Documentation

Observations: The Company’s Claim File Documentation Procedures are combined with the Company’s process for Claim Handling (Procedure 43) and Internal Claim Auditing (Procedure 44). The Company’s Claim Handling processes identify the use of proper documentation within the Company’s procedural processes. Additionally, the multiple levels of claim file reviews performed may only be detailed through the confirmation of claim documentation. During the review of claim audit materials provided by the Company, items which require documentation for “validation” entail the majority of review criteria.

Recommendation: None

Procedure 46 – Subrogation and Deductible Reimbursement

Observations: The Company maintains a Subrogation and Deductible Reimbursement Procedure. The procedure is designed to provide subrogation claim handlers information on the principles of subrogation, performing assessments and investigations, follow through negotiation and resolution strategies, and subrogation supervision.

The Company’s subrogation department relies on referrals from claim handlers who forward possible subrogation cases for review. Based upon information within the claim file the Subrogation Department will work with other departments, such as Risk Control and Legal, as needed.

Management of the Company's Subrogation Department indicates processes exist for monthly subrogation file reviews, monthly trend reporting and an analysis by management of the reported trends. The Subrogation Department maintains a similar management review hierarchy as indicated within other claim related procedures. The Company provided details of the type of information contained within both Company specific subrogation reports and business unit subrogation aggregate reports. Other than the tracking of the subrogation totals further management functions were not detailed.

Recommendation: None

SUMMARY

St Paul Surplus Line Insurance Company is incorporated under the laws of the State of Delaware to provide property and casualty insurance.

The examination was a baseline market conduct examination in which reviews of procedures affecting the following business areas were conducted: Company Operations/Management, Complaint Handling, Marketing/Sales, Producer Licensing, Policyholder Service, Underwriting & Rating and Claims. The review of written procedures included analysis of the controls used by the Company to manage its operations.

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

LIST OF RECOMMENDATIONS

Standard A-09 - Examination Cooperation

It is recommended that the Company develop a procedural action plan to facilitate examinations, in accordance with 18 Del. C. §320(c).

Procedure 07 - Managing General Agent (MGA) Oversight & Control

It is recommended that the Company establish follow-up procedures for all audit reports of MGUs and UAs. These procedures should ensure that any issues considered "unsatisfactory" are addressed and resolved.

Procedure 20 – Producer Selection, Appointment and Termination

It is recommended that the Company develop measurements and perform reviews at regular intervals to ensure surplus lines brokers' licenses remain in good standing.

Procedure 22 – Prevention of Use of Persons with Felony Conviction

It is recommended that the Company's Employee handbook include a provision to perform periodic background checks of employees throughout their tenure to ensure compliance with 18 U.S.C.A. §1033.

Procedure 25 – Correspondence Routing

It is recommended that the Company formulate and adopt a written Correspondence Routing Procedure based upon the internal processes already in place.

Procedure 26 – Policy Issuance

It is recommended that the Company review its procedures for detecting policy issuance and improper form usage errors and ensure that these errors are communicated to the underwriting staff in order to prevent their recurrence.

Procedure 28 – Insured or Member Requested Claim History

It is recommended that the Company formulate and document a process for responding to an insured's request for their claims history.

Procedure 32 – Underwriting and Selection

It is recommended that the Company develop appropriate remediation action plans to address recurring errors discovered through Company and MGU audit reviews.

Procedure 34 – Terminations

It is recommended that the Company develop clearly defined testing criteria for Terminations and Cancellations when self-audits and MGU audits are performed.

Procedure 35 – Underwriting File Documentation

It is recommended that the Company activate the remediation processes identified within its Underwriting File Documentation Procedures. It is recommended that the Company continually measure and reassess business entities until remediation plans have met the Company's own compliance standards.

Procedure 36 – Underwriting Training

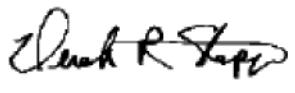
It is recommended that the Company develop continuing education requirements for Underwriters and a process for monitoring compliance with the requirements.

Procedure 40 – Staff Training

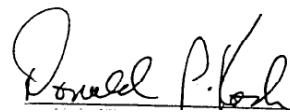
It is recommended that the Company develop continuing education requirements for staff as appropriate and a process for monitoring compliance with the requirements.

CONCLUSION

The examination, conducted by Donald P. Koch, Derek R. Stepp, Cindy Amann, James R. Koch, retired, and Sean Connolly, is respectfully submitted,



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