

Key Discriminatory Practices by Mercury Discussed in the CDI Documents

Introduction

The California Department of Insurance (CDI or Department) polices the marketplace by periodically undertaking examinations of insurance companies doing business in the state. Investigators visit an insurance company's offices and are entitled to review the company's underwriting rules and practices. The investigators also review a random sample of policyholder files to determine if policyholders are treated as the law requires. The Department's practice – reflected in the materials released by the Commissioner – is to allow insurance companies to review and contest the investigator's findings, until a final conclusion is reached. If the insurance company fails to correct its practices, the Department may bring an administration enforcement action to force the company to comply and to pay penalties of up to \$10,000 a day per willful violation.

The Mercury documents released by the Department consist of the following:

1. A June 14, 2004 cover memo from a department investigator to the head of the Field Rating and Underwriting Bureau (FRUB), the unit that conducted the examination, describing the nineteen issues raised by the examination, of which eight are listed as unresolved.
2. A June 14, 2004 memo requesting that the Department authorize an administrative prosecution of Mercury based on the unresolved issues, supported by a nineteen page memo and attaching 13 exhibits. The exhibits include:
3. The Department's 2002 Examination Report (Exhibit 1).
4. The Department's 1998 Examination Report, including an October 20, 2000 addendum (Exhibit 2).
5. Miscellaneous documents and correspondence (Exhibits 3-13).

The following is a summary, prepared by Consumer Watchdog, of what Consumer Watchdog believes are the most pernicious practices uncovered and alleged by the CDI. All references to statutes are to the Insurance Code unless otherwise noted. References to regulations refer to California Code of Regulations, Title 10.

The 1998 Examination and 2000 CDI Addendum

Agents Charging Broker Fees.

Under California law, insurance brokers who represent consumers may charge consumers a “broker fee” for their services. Sales agents, who represent an insurance company, cannot charge such a fee. Under Proposition 103, an insurance company must disclose all revenue to the Commissioner and can only charge rates that are approved as not excessive.

The Department found that Mercury treated brokers as sales agents, and in some cases demanded brokers rebate a portion of the fees they obtained from customers to the company. Thus Mercury collected premiums higher than was approved by the Commissioner and higher than was advertised to the public. The Department considered this a possible violation of Proposition 103’s rate control requirements (§ 1861.05(a)). The Department also alleged that Mercury’s advertising practices with respect to brokers violated § 790.03(b), and that Mercury’s practices regarding agents and brokers violated the agent-broker rules contained in §§ 1623, and 1704(a).

Resolution: The CDI drafted an administrative complaint against Mercury. Mercury sponsored legislation in Sacramento that it believed legalized its actions.

Source: 1998 Examination, p.4-5, 11, 114-115.

Mercury Increases Price from Amount Quoted to Applicants.

The Department found that Mercury would increase the price of the premium after Mercury’s sales agents quoted a lower price based on discounts that the agent subsequently failed to document. In a random sample of newly issued personal automobile insurance policies, investigators found that 48% of them had been adjusted upwards by Mercury. More than half of those were specifically due to Mercury and its agents removing discounts because Mercury’s agents had failed to submit the necessary paperwork or prepared the quote with incorrect information. Mercury sometimes requested the missing information, but other times simply issued the premium increase. The Department identified this practice as the single largest category of complaints about Mercury received by the agency. The agency noted the premium quote increases as a possible violation of Proposition 103’s rate control requirements (§ 1861.05(a)).

Resolution: Mercury contended the lack of documentation was the customer’s fault. The issue was marked as unresolved. On September 3, 1999, Mercury informed the Department that “We have modified our procedures to issue with discounts given by the agent and memo for proof if not submitted with the application.”

Source: 1998 Examination, p. 12, 54-55, 123.

High Error Rates.

Department investigators investigated the rate of mistakes Mercury made when setting a person's premiums (rating errors) or taking other actions related to a person's policy (non-rating errors). An error rate over 5% for personal lines and 10% for commercial lines is considered high, according to the Department. The Department found that 5.2% of personal auto policies and 16.3% of commercial auto policies had rating errors. Mercury had non-rating error rates of 8% for California Automobile Assigned Risk Plan motorists, 28% for commercial auto policies and 50% for commercial multi-peril policies. The Department noted rating errors are evidence of discriminatory practices that violate Proposition 103's rate control requirements (§ 1861.05(a)).

Source: 1998 Examination, p. 14-15.

Mid-Term Changes or Non-Renewals for Homeowners.

California law bars insurance companies from increasing insurance deductibles in the middle of the policy. Department investigators reported cases in which Mercury raised the deductible on the homeowner's coverage because of prior losses months after the policy had been taken out. Customers who did not agree to the higher deductible would be non-renewed. The Department reported this as a potential violation of §§ 678 and Proposition 103's rate control requirements (§ 1861.05(a)).

Resolution: The 1998 Examination reports this issue as resolved.

Source: 1998 Examination, p. 18.

Refusal to Sell Homeowners Insurance to Two Unrelated Individuals Living Together.

The Department noted that it had previously learned that Mercury had "declined to write a homeowners policy for two unrelated men who were co-owners of a dwelling" and had written Mercury in June 1997 that the practice was illegal under Department regulations, which prohibit: "Denying, cancelling or refusing to renew coverage, or providing coverage on different terms, because the insured or prospective insured is residing with another person or persons not related to him or her by blood or marriage." In November, 1997, Mercury agreed to stop the practice. However, according to the report, Mercury never corrected the practice and the Department learned of a similar cancellation in 1998. The Department reported this as a potential violation of its regulations (§2560.3). Consumer Watchdog believes this conduct may also be a violation of Proposition 103's anti-

discrimination provisions (§ 1861.05(a)) and California civil rights laws, such as the Unruh Civil Rights Act.

Resolution: The 1998 Examination reports that Mercury had not corrected its underwriting guidelines and that the issue was unresolved.

Source: 1998 Examination, p. 19.

Refusal to Sell Renters Policy to Unmarried Persons.

The Department noted that under Mercury's underwriting guidelines, the company would not sell renters coverage to "[s]ingle renters residing in a single family dwelling." The Department reported this discrimination based on marital status as a possible violation of its regulations (§2560.3). Consumer Watchdog believes such practices may also violate Proposition 103's anti-discrimination provisions (§ 1861.05(a)) and California civil rights laws, such as the Unruh Civil Rights Act.

Resolution: The 1998 Examination reports that Mercury agreed to delete this underwriting guideline.

Source: 1998 Examination, p. 20.

Requesting Information on National Origin.

The Department noted that Mercury's computer system asked the customer to state his or her "national origin." The Department stated: "The inclusion of the national origin information on a computer screen that is readily accessible by the underwriters could raise questions about the legality of Mercury's personal automobile policy cancellation and non-renewal decisions under CCR Section 2632.19 and [Insurance Code] Sections 1861.05(a), 1861.03(c)(1), and 11628(a)."

The Department also reported this as a potential violation of § 679.72, which prohibits insurance companies from asking for or including certain information on an insurance application or in underwriting documents. Depending upon whether the information was used by Mercury's underwriters as part of their "subjective" evaluation of customers, Consumer Watchdog believes this conduct may also be a violation of Proposition 103's anti-discrimination provisions (§ 1861.05(a)) and California civil rights laws, such as the Unruh Civil Rights Act.

Resolution: The 1998 Examination reports that Mercury agreed to block the data field from the screen.

Source: 1998 Examination, p. 20, 58.

Discriminatory Treatment of Military, Entertainment Industry, and Other Occupations.

The Department noted that Mercury's internal "occupational ineligibility" guideline mandated different treatment of people in certain occupations who did not qualify for the good driver auto insurance discount. Individuals in these applications would not be entitled to immediate coverage; instead, their applications were to be submitted to Mercury "unbound," meaning that Mercury would review the application and then let the person know whether they would be offered a policy and at what price. In today's modern insurance system, where people typically request and receive a quote and immediate coverage, requiring individuals to wait for Mercury to get back to them is a process that discourages consumers from doing business with the company. Moreover, the Department noted that "Some of the criteria that Mercury uses to evaluate these applications are unwritten," meaning that Mercury's underwriters could potentially act in an arbitrary manner on these applications. Finally, the Department noted that occupation was also the basis for Mercury's cancellation of some policies.

Applications from military personnel on active duty in the United States Armed Forces who did not qualify for good driver status were to be submitted "unbound." The Department stated that the practice was, "inconsistent with [Insurance Code] Section 11628(c), which states: 'No admitted insurer, licensed to issue and issuing motor vehicle liability insurance policies ... shall fail or refuse to accept an application, refuse to issue that insurance to an applicant therefore, or cancel that insurance solely for the reason that the applicant for that insurance or any insured is ... on active duty service in the United States Armed Forces.'" Moreover, the Department had raised the issue in a 1994 internal investigation of Mercury, and Mercury had agreed to correct it, but failed to do so.

Other occupations targeted for the "submit non-bound" process if the applicant was not eligible for the good driver discount: "drivers who are self-employed in businesses operated out of their places of residence"; "applicants employed in the entertainment industry as actors, dancers, et cetera"; "artists"; "emergency vehicle drivers" and even claims adjusters.

The Department also noted that Mercury would not even sell an auto policy to people in certain occupations, unless they qualified as good drivers: auto salespeople, employees of car dealerships, rental car company employees (unless the companies were "national" firms); messengers and certain car repair workers. For these customers, Mercury would only cover them if they were in an accident in a vehicle they owned.

Mercury also maintained a list of 26 occupations that were labeled “U” for unacceptable for personal umbrella policies (these are policies that provide additional coverage for home, auto and other risks). These included “military,” “domestics,” “artisans,” and “longshoremen.” Occupations rated “S” for umbrella policies to be “submit unbound” included “people who work out of their homes and have one source of income,” and “people who are self-employed and working out of their homes.”

The Department considered these practices as “unfair discrimination” and thus potential violations of Proposition 103’s anti-discrimination provisions (§ 1861.05(a)) as well as of §§ 11628(c) and 790.06; Proposition 103’s good driver requirements (§1861.02(b)); and of agency regulations (§§ 2360.2 and 2632.14).

Resolution: Mercury argued that Proposition 103’s protections do not apply to such discrimination, and that its practices were not in violation of the law. Mercury failed to provide any actuarial support for its criteria. The issue was marked as unresolved. In two memos issued in September 1999, Mercury stated that it would delete artists, emergency vehicle operators, insurance, military, students and entertainers from the “submit unbound” occupations list. On November 8, 1999, Mercury provided the CDI with a memo explaining in greater detail the criteria under which artists and the self-employed working from home could be declined for umbrella coverage.

Source: 1998 Examination, p. 25-26, 34-38, 117-119.

Discriminatory Treatment of Physically-Impaired.

The Department noted that Mercury utilized an internal “Physically-Impaired” rule under which Mercury may require a diabetic, a cardiovascular patient, or a person “who suffers from some other medical condition” to provide Mercury with a medical examination report, or else be denied auto or umbrella coverage. Moreover, Mercury had no written guidelines governing when its underwriters could insist on a medical exam. The Department found an instance in which a person submitted a favorable report and Mercury still refused coverage. The Department reported this practice as possible violations of Proposition 103’s anti-discrimination provisions (§ 1861.05(a)), § 790.06 and agency regulations (§ 2360.2). Consumer Watchdog believes this conduct may also be a violation of California civil rights laws, such as the Unruh Civil Rights Act, and state and federal disability rules.

Resolution: Mercury argued that Proposition 103’s protections do not apply to such discrimination, and that its practices were not in violation of the law. The issue was marked as unresolved. “Following the August 4, 1999 meeting, Mercury

agreed to ‘accept applicants with medical conditions if they qualify for the coverage, are licensed to drive, and have a satisfactory medical report.’”

Source: 1998 Examination, p. 26-28, 39-41, 120.

Discrimination Against the Unemployed.

The Department found that Mercury’s internal rules mandated that individuals who were unemployed would not be entitled to umbrella coverage on an immediate basis; instead, their applications were to be submitted to Mercury “unbound.”

Resolution: Mercury argued that Proposition 103’s protections do not apply to such discrimination, and that its practices were not in violation of the law. The issue was marked as unresolved. Later, Mercury provided the CDI with a memo stating that unemployed people could be declined for umbrella coverage “if the prior occupation was unacceptable.”

Source: 1998 Examination, p. 25-26, 118-119.

Discriminatory Treatment of Employees and Students from Other Countries.

The Department noted that Mercury’s internal “Unacceptable Drivers” guideline mandated that “students with less than 10 years residency in the United States” would not be sold coverage if they did not qualify for the good driver discount. The Department noted that it had raised the issue in a 1994 investigation of Mercury; “Mercury had agreed to discontinue the 10-year residency requirement in 1995, but has not done so.”

The Department also noted that Mercury’s internal rules bar good drivers from countries other than Canada and the United States from receiving the good driver discount required by Proposition 103 unless they were “continuously licensed to drive” for the preceding three years and had a valid U.S. or Canadian license “for all of the last 18 months.”

The Department considered these practices potential violations of Proposition 103’s Good Driver provisions (§§ 1861.02(b), 1861.025(d)), § 11628(a) and agency regulations (§§ 2632.13(i)).

Resolution: Mercury told the Department it had “no problem” insuring foreign students currently residing in the United States, but did not withdraw the rules with respect to non-good drivers or good drivers from other nations. The issue was marked as unresolved. After a meeting on August 4, 1999, Mercury agreed to eliminate the ten-year residency requirement. On March 21, 2000, Mercury told

the Department that “pending resolution of this issue,” it would offer the Good Driver Discount to those who provide a “verifiable, credible driving history.”

Source: 1998 Examination, p. 38-39, 42, 120, 121.

Surcharge for Tickets Where No Conviction

The Department noted that under its underwriting rules, Mercury would deny a policyholder good driver discount if he had more than one moving violation point on his record, even if the policyholder was not found guilty of the traffic violation.

The Department noted that this practice potentially violated agency regulations (§ 2632.13), which require that an insured be convicted of a traffic violation before an insurance company may surcharge them.

Resolution: The 1998 Examination reports that Mercury agreed to change its rule to comply with the law.

Source: 1998 Examination, p. 42.

Surcharges for an Accident When Not At Fault.

The Department investigators found that Mercury “automatically” charged a customer for “any accident” that shows up in an insurance industry database that collects claims data from other insurance companies, unless the claim is closed without payment or the database specifically shows that the motorist was not at fault. Thus a motorist who is involved in an accident caused by someone else would be treated by Mercury as if he or she caused the accident, even if the customer never submitted a claim to Mercury. The Department noted that the agency’s regulations (§ 2632.13(f)) require companies to undertake their own investigation of an accident and determine that the customer was “principally at fault” before surcharging the customer, and specifically bar insurance companies from engaging in the practice Mercury adopted.

The Department also noted that Mercury used total accident point counts reported by customers to set premiums, rather than at-fault accidents only, another possible violation of regulations (§§ 2632.5 and 2632.13).

The Department further noted that Mercury would treat any accidents on a customer’s Motor Vehicle Record (MVR) (a database maintained by the Department of Motor Vehicles) as the customer’s fault, and again remove any discounts the motorist is otherwise entitled to, resulting in higher premiums.

Resolution: Mercury argued that it had the right to continue its practice of relying on loss information from other sources. It also refused to correct the questions it asked its customers to answer regarding accidents. These issues were marked as unresolved. However, Mercury agreed to stop using MVR reports to increase customer's premiums improperly. On March 21, 1999, Mercury agreed to "verify chargeability," i.e. that the person was at fault.

Source: 1998 Examination, p. 43-44, 47-48, 55-56, 121-123.

Surcharges When License Lapsed

The Department investigators found that if a motorist's license lapsed for a period in excess of six months, Mercury denied the motorist the Good Driver Discount required by Proposition 103; Mercury applied this policy only to new applicants. The Department reported this as "unfair discrimination," a potential violation of Proposition 103's anti-discrimination provision, § 1861.05(a).

Resolution: The 1998 Examination reports that Mercury said it would change its rule to apply it to both new and existing customers.

Source: 1998 Examination, p. 45.

Failure to File Rating Rules with the Commissioner.

The Department investigators found that Mercury had failed to disclose to the Department some of the guidelines and practices that the agency considered potentially illegal. The Department reported this as a possible violation of Proposition 103's requirement that insurance companies file and obtain approval from the Insurance Commissioner of all rates and practices prior to their use (§ 1861.05(b)).

Resolution: The 1998 Examination reports that Mercury agreed to file its guidelines with the Commissioner as required by law.

Source: 1998 Examination, p. 46.

Incentive Program for Mercury Employees to Deviate from Rules.

According to the examination, Mercury issued demerits to its underwriters for errors in their work. The system penalized Mercury employees who did not deviate from written rules in order to reject applications: "underwriters receive a relatively high number of demerits for issuing policies for risks that are not disqualified by the manual's ineligibility criteria, but which are nevertheless deemed by management to be 'unacceptable.'" The Department determined that this incentive

program, which attempted to substitute unwritten criteria and the “underwriter's judgment” for a “risk [that] is technically acceptable according to the manual,” was a possible violation of its regulations (§§ 2360.2 and 2632.2) and led to unfair discrimination between customers that would be in violation of Proposition 103’s anti-discrimination provisions, §§ 1861.05(a), 1861.02(b)(1), as well as § 790.06.

The Department found that 22% of the “declined policy” files it reviewed were in fact eligible to purchase auto insurance under Mercury’s eligibility guidelines.

The Department also found that Mercury encouraged its underwriters to “exercise independent judgment” when renewing drivers. The Department found that 5% of the non-renewed policy files it reviewed were in fact eligible for renewal, and attributed this to the leeway underwriters were given by Mercury to depart from its written rules to terminate policies.

Resolution: Mercury contended that its conduct was lawful. The issue was marked as unresolved. Mercury later agreed to “document...reasons for deviating” from its guidelines.

Source: 1998 Examination, p. 61-65, 124-125.

The 2002 Examination and 2004 CDI Referral Memo

Non-Renewals for Failure to Verify Application by Phone

The Department found that Mercury cancelled or refused to renew auto insurance policies if it could not conduct a telephone interview with some of its customers in addition to the written application. The decision whether to waive the interview requirement was sometimes left to Mercury’s “judgment.” This was a major issue in the 1998 examination as well. The Department determined that this practice may have violated the conditions under which an insurance company may cancel or refuse to renew a policy as set forth in Proposition 103 (§ 1861.03(c)) and that allowing employees to determine whether to require an interview could result in discriminatory treatment (§ 1861.05(a)).

Resolution: Mercury argued that Proposition 103’s protections did not extend to underwriting practices. Issue unresolved.

Source: 2004 CDI Referral Memo, p. 3-4, 2002 Examination pp. 17-18.

Non-renewal for Tickets Where No Conviction.

In its 1998 Examination, the Department noted that under Mercury’s underwriting rules, Mercury would deny a policyholder good driver discount if she

had more than one moving violation point on his record, even if the policyholder was not found guilty of the traffic violation. (See above.) In the 2002 Examination, the Department determined that Mercury would use that MVR information as a basis to non-renew the policy.

The Department noted that this practice appeared to violate Proposition 103's non-renewal provision (§ 1861.03(c)(1)) and agency regulations (§ 2632.5) that require that an insured be convicted of a traffic violation before an insurance company may surcharge them.

Resolution: Mercury argued that the regulation does not bar the practice. Issue unresolved.

Source: 2004 CDI Referral Memo, p. 9-10, 2002 Examination pp. 20-21.

Unwritten Underwriting Practices.

A recurrent theme of the 1998 Examination was that Mercury lacked objective, written underwriting guidelines governing underwriting practices. The 2002 examination noted that Mercury had agreed to address this issue after the 1998 exam by following objective guidelines for non-good drivers, and to update its guidelines to reflect changes. The Department stated that, "[t]he current exam shows that Mercury did not honor this commitment." The Department again alleged that failure to do so constituted a violation of Proposition 103.

Resolution: Issue unresolved.

Source: 2004 CDI Referral Memo, p. 7-8, 2002 Examination p. 20.

Cancellation of "Assigned Risk" Policies.

Under California law, persons who are unable to obtain auto insurance coverage in the marketplace because insurance companies refuse to sell it to them are entitled to buy a policy through the "California Automobile Assigned Risk Plan" (CAARP). The plan randomly assigns such customers to each insurance company. As the "insurer of last resort," CAARP's policies may not be cancelled except on very limited grounds, such as fraud or misrepresentation. The Department's investigators learned that Mercury would seek to cancel CAARP customers who failed to complete telephone questionnaires or fill out a form excluding ineligible drivers from the CAARP coverage. The Department determined that this was a violation of the law. In its 1998 examination, the Department noted a similar problem (pp. 69-71).

Resolution: The Department stated that, “Mercury has made no change to its practices to correct this problem.” Issue unresolved.

Source: 2004 CDI Referral Memo, p. 11, 2002 Examination pp. 21-22.

Refusal to Sell Homeowners Insurance Without Auto Insurance.

For marketing purposes, Mercury refused to sell homeowners coverage to a person who did not purchase auto coverage. The Department noted this as a possible violation of numerous provisions of Proposition 103, including §§ 1861.02(b)(1), 1861.03(a) (antitrust laws), 1861.05(a), as well as §§ 790.02 and 790.06 and regulations (§§ 2360.0(b) and 2360.2).

Resolution: According to the Department, “Mercury had informed the Department that it had ceased this practice on August 29, 2002. However, as of December 2003, it was confirmed by the Department's attempt to obtain quotes for stand alone homeowners coverage that Mercury still requires a supporting auto policy in order to obtain coverage.”

Source: 2004 CDI Referral Cover Memo, p. 2; 2004 CDI Referral Memo, pp. 12-13; 2002 Examination pp. 22-24.

Refusal to Give Full Discounts.

According to the report, Mercury had obtained the Department's approval for a total of 45% in combined discounts to be offered to commercial auto insurance policyholders. However, Mercury capped the total discounts on any one policy to 25%. The Department determined that this practice would allow Mercury to charge rates in excess of what was approved and also that “some insureds will not receive the full premium benefit of the credit,” potential violations of Proposition 103's rate control and anti-discrimination provisions (§ 1861.05(a)).

Resolution: Mercury contended that because the Department had already approved its rate and class plan filings, they were lawful and the Department could not challenge Mercury's practice. Issue unresolved.

Source: 2004 CDI Referral Cover Memo, p. 2; 2004 CDI Referral Memo, pp. 14; 2002 Examination pp. 24 - 25.

Surcharge for No Prior Insurance.

Proposition 103 prohibits insurance companies from charging drivers applying for coverage more just because they previously did not have auto insurance coverage (§ 1861.02(c)). Mercury was found to be violating that provision of the law and

concealing the violation from the Commissioner. Mercury surcharged motorists who had not been previously insured, or a lapse of coverage of more than thirty days over the preceding five years.

The Commissioner issued regulations in 2002 barring Mercury's attempt to conflate loyalty discounts, which are authorized, with a discount granted only to people who have been insured by any company.

After the 2002 Examination, the Department also discovered that Mercury had conditioned its no prior credit on an insured having no losses for the preceding five-year period. Thus consumers would also be surcharged if they had maintained coverage but had had a loss – even one that was not their fault. This had been concealed from the Department as well.

The Department determined that these practices were a violation of Proposition 103.

Resolution: The Department stated that “[t]he [2002] report shows this as resolved, but new information from the company indicates that they never made the filing promised to correct the problem.” (Mercury later sponsored legislation purporting to repeal 1861.02(c); it was later held an invalid amendment to Proposition 103).

Source: 2004 CDI Referral Cover Memo, p. 2; 2004 CDI Referral Memo, pp. 15-16; 2002 Examination p. 25.