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OFFICE OF THE
NEW MEXICO PUBLIC REGULATION
COMMISSION
INSURANCE DIVISION



CERTIFICATE

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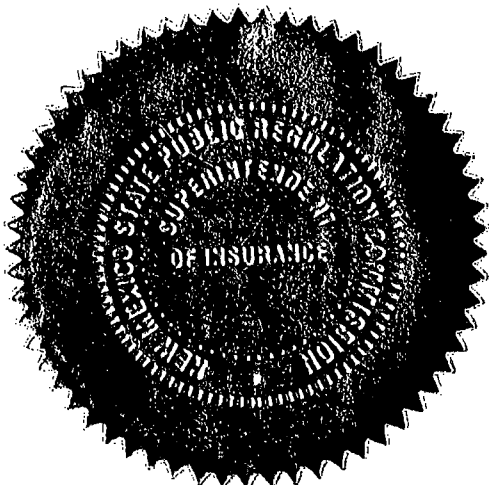
I, Thomas R. Rushton, Superintendent of Insurance of the State of New Mexico, do hereby certify that the attached Report of Examination for the period ending July 30, 2004 on:

Progressive Insurance Group
6300 Wilson Mills Road W33
Mayfield Village, Ohio 44143-2182

Was recently completed by *Nestor J. Romero*, Examiner-In-Charge with the Insurance Division.

Due consideration has been given to the comments of the Examiner regarding the financial condition and business affairs as reflected in this report.

The report as of this date is hereby adopted, filed and made an official record of the Division.



In Witness Whereof, I have hereunto set
my official seal On this 20th
day of June, 2006 A.D.

Thomas R. Rushton
Superintendent of Insurance

STATE OF NEW MEXICO

COUNTY OF SANTA FE

Nestor J. Romero, CPA, CFE, CIE being duly sworn, upon his oath deposes and says:

That he is an examiner appointed by the Superintendent of Insurance of the State of New Mexico;

That an examination was made of the affairs of the Progressive Insurance Group for the period ending July 30, 2004;

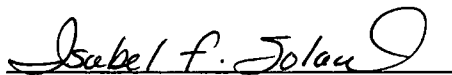
That the following twenty-eight (28) pages constitute the report thereon to the State of New Mexico Division of Insurance Superintendent;

And that the statements, exhibits, and data therein contained are true and correct to the best of his knowledge and belief.



Nestor J. Romero, CPA, CFE, CIE
Examiner-In-Charge

Subscribed and sworn to before me this the 20th day of June 2006.


(Signature)

Isabel F. Solano Notary Public
(Print Name)

in and for the State of New Mexico

My commission expires June 6, 2009

REPORT OF THE MARKET CONDUCT EXAMINATION

OF

PROGRESSIVE INSURANCE GROUP

(As of July 30, 2004)

Progressive Preferred Insurance Company

NAIC # 37834

Progressive Specialty Insurance Company

NAIC # 32786

Progressive Casualty Insurance Company

NAIC #24260

Progressive Northern Insurance Company

NAIC #38628

Progressive Northwestern Insurance Company

NAIC #42919

Progressive Classic Insurance Company

NAIC #42994

Progressive Halcyon Insurance Company

NAIC #16322

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December 19, 2004

Honorable Eric P. Serna
Superintendent of Insurance
New Mexico Department of Insurance
Post Office Box 1269
Santa Fe, New Mexico 87504-1269

Dear Superintendent Serna:

Pursuant to your instructions and in accordance with NMSA 1978, §59A-4-5, an examination has been made of the business affairs and market conduct operations of the PROGRESSIVE INSURANCE GROUP, including

Progressive Preferred Insurance Company (PPIC)
Progressive Specialty Insurance Company (PSIC)
Progressive Casualty Insurance Company (PCIC)
Progressive Northern Insurance Company (PNIC)
Progressive Northwestern Insurance Company (PNWIC)
Progressive Classic Insurance Company (CIC)
Progressive Halcyon Insurance Company (PHIC)

(Hereinafter referred to as PPIC, PSIC, PCIC, PNIC, PNWIC, CIC, or PHIC or the companies collectively as Progressive or the Company) as of June 30, 2003, and the report thereon is hereby respectfully submitted.

EXECUTIVE SUMMARY

The following are the material findings made by the examiners during the onsite examination of The Progressive Insurance Group:

1. **Delays in providing necessary information:** The Company failed to provide timely, convenient, and free access to all books, records, accounts, documents and any or all computer or other recordings in apparent violation of NMSA (1978) § 59A-4-7(B).
2. **Rate Filings:**
 - The examiners identified three rate-related changes where the Company did not provide the Division with notice of the changes to its rate related rule guidelines, in apparent violation of NMSA (1978) § 59A-17-9.
 - The failure to file the classification of Underwriting and Credit tiers during the consolidation of business constitutes a deviation from filed rates and supplemental rate related rules in apparent violation of NMSA (1978) § 59A-17-9 and 59A-17-12.

FOREWORD

The Company examined in this Report of Market Conduct Examination ("Report") is the Progressive Insurance Group collectively referred to as "Progressive," or the "Company." The Progressive Insurance Group consists of seven companies, which are:

- Progressive Preferred Insurance Company ("PPIC");
- Progressive Specialty Insurance Company ("PSIC");
- Progressive Casualty Insurance Company ("PCIC");
- Progressive Northern Insurance Company ("PNIC");
- Progressive Northwestern Insurance Company ("PNWIC");
- Progressive Classic Insurance Company ("CIC"); and
- Progressive Halcyon Insurance Company ("PHIC").

This examination was conducted in accordance with New Mexico Statutes Annotated (1978), Chapter 59A, and New Mexico Administrative Code, Title 13 (hereinafter "NMSA (1978)" and "NMAC" respectively). Specifically, this examination was conducted under the authority of NMSA (1978) §§ 59A-4-1, *et seq.* Company personnel provided the examiners with the information that is included in this Report.

SCOPE OF EXAMINATION

The scope of this examination was limited to the Company's private passenger automobile line of business. This targeted examination focused on the Company's underwriting and rating practices, as well as its handling of cancellations and consumer complaints. The purpose of the examination was to determine the Company's compliance with New Mexico's insurance laws related

to the underwriting and rating of personal lines automobile coverage and to determine whether the Company's operations and practices are consistent with the public interest. Special attention was paid to the use and handling of Comprehensive Loss and Underwriting Exchange ("C.L.U.E.") information and credit report scoring. C.L.U.E. is a trademark of ChoicePoint for its reports of accident and loss history information. Both loss reports and credit reports, singularly and collectively, were used for the purposes of determining an applicant's Company acceptability and premium rate tiers, which in turn determine the insured's premium level. This examination was called for the period from January 1, 2001 through June 30, 2003 and later expanded to mid-2004.

Independent examiners conducted this examination pursuant to the insurance laws of the State of New Mexico, as authorized by New Mexico Statutes Annotated (1978) ("NMSA (1978)") § 59A-4-5. The examiners performed their reviews in accordance with the procedures and guidelines established by the National Association of Insurance Commissioners ("NAIC").

Certain unacceptable or non-complying practices may not have been discovered due to the limited scope of this examination. Failure to identify or issue findings regarding specific Company practices does not constitute acceptance by the Division.

In accordance with the Division's procedures, the examiners issued findings on those files, forms, and/or practices found to be in apparent violation of New Mexico laws. The examiners submitted Preliminary Findings to the

Company representatives designated by management as being knowledgeable about the issues raised in the examiners' findings for their review and comment.

METHODOLOGY

The examiners requested hard copy and/or electronic listings of data and information related to complaints, new business issued, and cancellations. The Company did not provide the requested data throughout the examination in a timely fashion or to a level of satisfactory completeness, resulting in increased examination time and cost. The "Access to Information/Product of Records" section discusses this issue at length.

The examiners also requested copies of the following materials in use during the examination period:

- Personal Auto Rate Manuals and underwriting guides, underwriting bulletins, agent or producer bulletins, Intranet and other inter-office bulletins to staff or agent/producers;
- Specimen applications, policy forms, and billing notices;
- Cancellation codes, automobile symbols, and rating territories.

The examiners requested and did not receive access to the Company's Intranet web site(s) available to the Company's agents and employees. The examiners received a one-hour overview of the Intranet web site by a Company employee/training instructor. Progressive's web site accessible to the public is available at www.progressive.com. The examiners requested access to the Company's LAN for policy information and review. The Company did not allow the examiners any direct access to the LAN.

During the course of this examination, the examiners identified apparent deficiencies and issues relating to the affairs and market conduct operations of the Company. These are deemed to be apparent until the adoption of this Report by the Superintendent at which time the report shall be admissible as evidence of the facts pursuant to NMSA (1978) § 59A-4-13(A).

Complaint Data

The examiners received a list and original files of 135 complaints received during the examination period for the private passenger automobile line of business. The examiners reviewed 100% of the complaint files.

Automobile Policy Data

The examiners received electronic listings of private passenger automobile policies in force and cancellations processed during the examination period. The examiners received lists of policy counts by credit score ranges so that the examiners could determine the distribution ratio by credit score ranges within each company to the total number of policies written by each company. The examiners then requested a stratified random sampling of files from each credit score range to match the distribution percentage of policy count totals. (For example, if the NAIC sample for a given company was 100 and that Company's ratio of a particular credit score to its total policy population was 10%, the examiners requested a random sample equal to 10% or 10 policies from that particular credit range group of policies. The examiners chose this process to insure that an adequate sample was reviewed from each credit score stratum,

including "No Hits" and "Thin Files."¹ The examiners and the Company referred to the files produced for each stratum in this process as "bucket" files, and hereafter in this Report "bucket files" indicate the random samples selected from each credit score stratum.

¹ As defined later in this report, the terms "No Hits" and "Thin Files" refer respectively to credit reports indicating an insured has no credit history or an insufficient credit history from which to generate a credit score.

The populations and random samples follow:

Table I – Policies in Force

<u>Company</u>	<u>Population</u>	<u>Sample Size</u>
PPIC	11,749	100
PSIC	6,283	100
PCIC	1,387	50
PNIC	16,411	100
PNWIC	3,675	50
CIC	14,684	100
PHIC	6,733	100
Total	60,962	600

Table II – Cancellations/Nonrenewals

<u>Company</u>	<u>Population</u>	<u>Sample Size</u>
PPIC	9,481	100
PSIC	6,863	100
PCIC	1,927	50
PNIC	5,799	100
PNWIC	5,269	100
CIC	7,523	100
PHIC	1,837	50
Total	38,699	600

File Review Methodology

- Log and track the files reviewed, as well as examination requests and findings;
- Confirm compliance with filed rating protocols; written underwriting rules and guidelines and to identify any trends that indicate underwriting/rating rules that are not written;
- Calculate compliance with New Mexico insurance laws regulating timeliness;
- Perform time-study analysis.

STATUTES AND RULES CITED

The examiners may allege that a Company has apparently violated certain sections of the New Mexico Insurance Code. The New Mexico Superintendent of

Insurance ("Superintendent") or his designee will make any final finding of violations as may be justified by the facts. The examiners have alleged that the Company is in apparent violation of the following New Mexico statutes: NMSA (1978) §§ 59A-4-7, 59A-17-9, and 59A-17-12.

In addition to the insurance statutes and rules cited for potential violations, this Report references NMSA (1978): §§ 59A-4-1, *et seq.*, and 59A-17-7.1.

HISTORY OF THE COMPANY

The Progressive Group of Insurance Companies is a group of foreign property and casualty insurers authorized to transact insurance business in the State of New Mexico, and are subject to the jurisdiction and regulation of the Division, pursuant to the New Mexico Insurance Code.

Progressive is the fourth largest writer of private passenger automobile insurance in the United States and the nation's largest writer of private passenger automobile insurance through independent agents. Its corporate offices are located in Mayfield Village, Ohio.

The following table provides the incorporation information for each of the Progressive Companies under review:

Table III – Incorporation Information by Company

<u>Company</u>	<u>State of Domicile</u>	<u>Type of Company</u>	<u>Date of Incorporation</u>	<u>Commenced Operation</u>
PPIC	OH	Stock	09/24/79	04/15/80
PSIC	OH	Stock	08/04/75	05/26/76
PCIC	OH	Stock	11/17/56	12/11/56
PNIC	WI	Stock	08/19/80	03/08/81
PNWIC	WA	Stock	09/24/82	09/26/83
CIC	WI	Stock	09/30/83	03/05/84
PHIC	OH	Stock	09/29/86	01/14/87

MARKETING AND OPERATIONS

The Company markets its private passenger automobile products through a dual marketing distribution system of independent agents located throughout New Mexico, and direct written marketing and issuance through Progressive's web site and on-line service centers. The New Mexico new direct written business is handled mostly out of Mayfield Village, Ohio and in Austin, Texas.

The Company's operating results in New Mexico for the calendar years 2001, 2002 and 2003 are shown below:

Table IV – Annual Premiums & Loss Ratios by Company

PPIC	<u>Year</u>	<u>Written Premium</u>	<u>Earned Premium</u>	<u>Losses Incurred</u>	<u>Loss Ratio</u>
	2001	\$ 12,654,656	\$ 12,887,597	\$ 7,734,294	60%
	2002	\$ 17,321,694	\$ 16,441,911	\$ 10,490,333	64%
	2003	\$ 21,729,852	\$ 20,885,238	\$ 10,029,938	48%

PSIC	<u>Year</u>	<u>Written Premium</u>	<u>Earned Premium</u>	<u>Losses Incurred</u>	<u>Loss Ratio</u>
	2001	\$10,388,394	\$11,772,501	\$ 7,338,078	62%
	2002	\$ 9,256,476	\$10,429,505	\$ 6,492,002	62%
	2003	-122,740	2,563,779	1,283,051	50%
PCIC	<u>Year</u>	<u>Written Premium</u>	<u>Earned Premium</u>	<u>Losses Incurred</u>	<u>Loss Ratio</u>
	2001	\$ 3,242,917	\$ 3,583,144	\$ 1,875,305	52%
	2002	\$ 3,134,861	\$ 3,209,297	\$ 2,374,001	74%
	2003	\$ 2,688,357	\$ 2,856,470	\$ 1,206,383	42%
PNIC	<u>Year</u>	<u>Written Premium</u>	<u>Earned Premium</u>	<u>Losses Incurred</u>	<u>Loss Ratio</u>
	2001	\$ 2,762,623	\$ 2,165,173	\$ 1,383,173	64%
	2002	\$ 8,272,560	\$ 5,797,695	\$ 3,334,321	58%
	2003	\$24,334,541	\$20,913,531	\$10,438,038	50%
PNWIC	<u>Year</u>	<u>Written Premium</u>	<u>Earned Premium</u>	<u>Losses Incurred</u>	<u>Loss Ratio</u>
	2001	\$16,944,774	\$17,115,839	\$10,986,621	64%
	2002	\$18,101,671	\$17,774,915	\$ 9,228,396	52%
	2003	\$13,600,016	\$13,981,853	\$ 5,364,055	38%
CIC	<u>Year</u>	<u>Written Premium</u>	<u>Earned Premium</u>	<u>Losses Incurred</u>	<u>Loss Ratio</u>
	2001	\$10,915,077	\$ 9,742,335	\$ 5,143,112	53%
	2002	\$ 14,204,498	\$14,883,124	\$ 7,567,438	51%
	2003	\$ -130,802	\$ 2,988,741	\$ 1,555,087	52%
PHIC	<u>Year</u>	<u>Written Premium</u>	<u>Earned Premium</u>	<u>Losses Incurred</u>	<u>Loss Ratio</u>
	2001	-0-	-0-	-0-	0%
	2002	\$ 2,694,806	\$ 516,269	\$ 208,612	40%
	2003	\$23,657,848	\$19,251,493	\$10,616,301	55%

Advertising

Progressive advertises on the radio, television, and Internet, as well as in the white and yellow page telephone directories.

OPERATIONS AND MANAGEMENT

Internal Audits

The examiners requested copies of the Company's internal audit procedures and audits conducted during the examination period, with special emphasis on the handling of credit reporting and use of loss history information (C.L.U.E. reports). The Company indicated they did not conduct internal audits regarding CLUE reports during the examination period.

Computer Systems

The Company uses a system of computers and proprietary computer software to order motor vehicle reports and consumer reports and to rate, issue and endorse its books of personal automobile business

ACCESS TO INFORMATION/PRODUCTION OF RECORDS

The examiners reviewed the level of timeliness, completeness, and accuracy of requested documents throughout the course of the examination pursuant to NMSA (1978) § 59A-4-7(B), which states:

Every company or person from whom information is sought, its officers, directors and agents must provide to the examiners appointed under Subsection A of this section timely, convenient and free access at all reasonable hours at its offices to all books, records, accounts, papers, documents and any or all computer or other recordings relating to the property, assets, business and affairs of the company being examined. The officers, directors, employees and agents of the company or person shall facilitate the examination and aid in the examination so far as it is in their power to do so. The refusal of any company, by its officers, directors, employees or agents, to submit to examination or to comply with any reasonable written request of the examiners shall be grounds for suspension or refusal of, or nonrenewal of, any license or authority held by the company to engage in

insurance or other business subject to the superintendent's jurisdiction.

The Company's response, or lack thereof, to written requests to produce records, data and information was the source of many delays in this examination.

Delays/Incomplete Information Prior to Onsite Examination

The examiners originally planned the onsite examination for early October 2003. At the Company's request, the examiners agreed to postpone their entrance onsite and began their review from the examiners' offices in Phoenix, Arizona. The actual onsite examination did not begin until December 8, 2003.

From early October until December 8, 2003, the examiners were able to review most of the Progressive Complaint files and some Cancellation files. However, this review was not without delays and difficulties. The following is an enumeration of some of those details.

1. The examiners requested fifty Cancellation files for review on October 14, 2003. On November 5, 2003, 22 days later, the examiners received the first batch; however, the Company had redacted vital information from the cancellation notices. This redaction made the documents unfit for review, because they did not contain necessary information. The excised portions included pertinent information such as where and when to send the notices and the names and addresses of the insureds. Therefore, the examiners had to go back and forth from the notices to the Company's computer runs to obtain all of the necessary information. This was time consuming and the examiners expended additional hours due to the Company's actions.

2. Although, the second batch of cancellation notices were not redacted, it took the Company 30 days beyond the requested due date to provide the information. The examiners received the notices on November 24, 2003.
3. On November 5, 2003, the examiners requested 10 complaint files involving claims. The Company's response took 20 days; which was ten days past the response due date.

On November 12, 2003, the examiners requested 50 policies to underwrite and rate. The examiners did not receive any policies until December 8, 2003. On this date, the Company provided only portions of the necessary policy information.

Delays Resulting in Duplication of Work

In addition to the aforementioned delays and incomplete information provided, the Company's failure to produce basic information at the beginning of the Examination required the examiners to revisit the same files and issues several times. These delays can best be seen and understood from the issues that they involve.

1. **Credit Scores & Credit Tiers:** On February 3, 2004 (57 days after the beginning of the onsite examination), it became evident that the Company had material information (numeric scoring bands with assigned credit tiers) that had not been provided to the examiners. These score bands fed into and resulted in the creation of the Company's alphanumeric Credit Tiers (A1 to Z1). The lack of this

information, which had been originally requested through the initial Data Call in August 2003, caused numerous delays and extra examination hours because all the files reviewed from December 8, 2003, through February 3, 2004 had to be reviewed a second time based upon this new information.

2. **Teleconference of June 14, 2004:** The delays and examination difficulties resulted in a teleconference on June 14, 2004 with the Company's counsel, three Company contact individuals, the Insurance Division Chief examiner, the examiner in-Charge, and the Examination Supervisor. During this teleconference, "mutual agreements" were made on the following:

a. The examiners would finish their review of the Company's selected sample review files (bucket files) and the cancellation files that were still outstanding. Upon receipt of this data the examiners would have enough information on the bucket files to adequately conduct their review.

b. The Company agreed to rate 50 PHIC and 50 PNIC files plus provide a comparison rate sheet of the 50 PNIC files "as they would have been" had the policies been rated through the Company's (*direct Market*) PHIC and vice versa with the PNIC files.

The Company's failure to provide the examiners timely, convenient, and free access to all books, records, accounts, documents and any or all computer or other recordings resulted in many delays in apparent violation of NMSA (1978)

§ 59A-4-7(B). The Company's actions caused additional examination hours that accrued to months of extra examination cost.

The Company noted, and the Examiners acknowledged, that the Company has implemented numerous changes to its document retention program to improve the process for future examinations.

UNDERWRITING, RATING AND FILINGS

The Company's underwriting, rate filings and rate related underwriting rules, uses a combination of Credit tiers, Underwriting (U/W) tiers and Market (Mkt) tiers. However, the discussion of the three tiers together is necessitated by the operational interdependence of the three tiers.

The Examiners requested copies of the Company's underwriting guidelines, filed rating methodologies and rates in effect during the examination period, including C.L.U.E. and credit scoring information.

The Examiners reviewed the Company's placement and rating of new and renewal business in relationship to the Company's tiering assignments. This included a review of the Company's use of credit and C.L.U.E. information in order to verify compliance with filed programs and rate filings and New Mexico Statutes concerning the use of not-at-fault accidents and the prohibitions of unfair discrimination. NMSA (1978) § 59A-17-7.1(A) governs the treatment of not-at-fault occurrences and states:

The rates of a motor vehicle liability insurer shall not provide for an increase in the premium if based upon an accident in which the insured is not at fault in any manner as determined by either the accident report or the insurer. If the insurer determines that its insured is at fault contrary to the specific finding of an accident

report that the insured is not at fault, the insurer shall reach its conclusion only after an investigation.

NMSA (1978) § 59A-17-9 mandates that insurers file their rates, as well as supplementary rate information:

As to insurance subject to Chapter 59A, Article 17 NMSA 1978, other than workers' compensation insurance, every insurer shall file with the superintendent all rates and supplementary rate information and all changes and amendments thereof made by it for use in this state at least sixty days before their proposed effective date. No filing made pursuant to this section shall become effective nor shall it be used until approved or deemed approved by the superintendent in accordance with Section 59A-17-13 NMSA 1978, at which time it may be used.

NMSA (1978) § 59A-17-12 (A). Insurer must adhere to rates, states:

No insurer shall make or issue a contract or policy of insurance except in accordance with filings or rates which are lawfully in effect for the insurer as provided in this article.

As previously noted in this report, NMSA (1978) § 59A-17-4(C) defines "supplementary rate information" as follows:

"supplementary rate information" includes any manual or plan of rates, statistical plan, classification, rating schedule, minimum premium, policy fee, rating rule, rate-related underwriting rule and any other information prescribed by rule of the superintendent.

Finally, the Examiners considered the Company's underwriting operations in terms of NMSA (1978) § 59A-16-17(D), which prohibits unfair discrimination:

No such insurer or organization shall make or permit any unfair discrimination between insureds or property having like insuring or risk characteristics, in the premium or rates charged for insurance or coverage, or in the dividends or other benefits payable thereon, or in any other of the terms and conditions of the insurance or coverage.

The Examiners will present the following background information on the company's multifaceted scoring and tiering program rates and procedures with special emphasis on the interplay between the U/W, Credit and Mkt tiers.

Background – Credit Scoring, U/W & Credit Tiers and Mkt Tiers

Credit Scoring

The Company uses credit scoring to develop its credit tier structure based on specific score ranges. In the earlier years of 1999 and 2000, this structure consisted of five credit tiers (A1 through E1). Once the credit tier was assigned, then the underwriting and Mkt tiers could be determined as outlined below for the placement of both new and renewal business. The credit scores were later expanded from five bands to 18 bands along with their credit tier counterparts.

U/W & Credit Tiers

The Company also has seven U/W tiers (A1 through G1, not to be confused with the five credit tiers mentioned above). The Company assigned U/W tiers to a policyholder based upon three non-subjective underwriting eligibility criteria: (1) the existence of prior insurance and the prior limit of liability, (2) number of non-chargeable incidents, and (3) the credit tier.

1. **Prior Insurance**: This criteria considers whether the named insured has proof of private passenger automobile liability insurance which verifies that the previous policy covered the named insured or rated spouse and provided six months' continuous liability coverage. Prior limits are those limits that were in force on the applicant's prior policy for a minimum of six months immediately preceding the Progressive policy. The Company further considers:

- whether there was a lapse in coverage prior to the inception of the Progressive policy, and
- the limit of liability on the prior term's policy.

2. **The Number of Non-Chargeable Incidents:** The number of non-chargeable incidents is the total sum of the number of not-at-fault accidents and the number of comprehensive claims of \$1,000 or more.

- The number of not-at-fault accidents reflect whether, there were 0, 1, 2, or three or more not-at-fault accidents (including Personal Injury Protection claims and Uninsured/Underinsured Motorist claims) for all rated drivers on the policy during the "chargeable period."
- The number of Comprehensive claims of \$1,000 or more reflects whether there were 0, 1, 2, or equal to or greater than 3 comprehensive claims of \$1,000 or more for all rated drivers on the policy during the "chargeable period". The Company obtains underwriting information from the applicant, and the MVR's, and C.L.U.E. Reports.

3. **The Financial Responsibility (Credit Tier):** The third step in the process is to develop a Financial Responsibility tier. The Company uses this term "Financial Responsibility" to refer to its internally developed alphanumeric "credit tier". The actual credit score calculation is based on Progressive's proprietary algorithm which is discussed later in this Report.

Mkt Tiers

Progressive has five "Mkt Tier" level assignments within each Company.

The Mkt Tiers are as follows:

1. Ultra Preferred (UL),
2. Preferred (PR),
3. Standard (ST),
4. Middle Mkt (MM), and
5. Nonstandard (NS).

These five Mkt tiers are utilized in each Progressive Company and is the result of the U/W tier in combination with the credit tier. The Mkt tier has nothing to do with the selection of a particular Company. The Company selection is determined by the Agent based upon varying commission levels offered by the Company, or it is determined by the customer's decision to come to Progressive via the Company's direct venues, which are either the internet or the Company's direct 1-800 Call Centers.

Rating Plans

In June of 2000, the Company introduced a new rating plan referred to as the 'Continuous' ('C') Product – Rate Plan 3. With this new plan, the Company began a process of rolling over its renewal business on the insured's anniversary date. There were many differences between the old and new rating plans, but the largest impact was the expansion of the credit tiers from five to eighteen. The Company revised the score ranges within eighteen new credit tiers.

Filing Changes and Company Consolidations

In October of 2002, the Companies converted existing rating programs into one product with the expansion from five to eighteen credit score ranges. The Companies began the process of consolidation with the October 2002 filing. The Progressive Group of Insurance Companies' marketing strategy was to

consolidate business written in its companies into a smaller number of companies. This resulted in a rollover of books of business from three of the seven companies examined. The rollover occurred on the insured's anniversary date.

The examiners reviewed the Companies' rate filings under New Mexico statutes requiring companies to file all changes and amendments of all rates and supplementary rate information, specifically NMSA (1978) § 59A-17-9.

The Companies' filings did not clearly reflect the methodology used by the Companies' in transitioning to their new consolidated program. To effect this transition, the Companies placed renewal policyholders into underwriting and credit tiers that resulted in a rate not drastically different from their current rate. This was done in order to avoid the shock of significant rate changes. The Companies' practices resulted in some renewal policyholders receiving less favorable underwriting placement than they would have received had the Companies not sought to avoid significant rate shock and other renewal policyholders receiving more favorable placement.

In conclusion, the Companies' transitional underwriting placement employed during the company consolidation process constituted a failure to follow its filings resulting in apparent violations of NMSA (1978) § 59A-17-9. The examiners recommend and the Companies' have agreed that the Companies' perform a self-audit of all affected policyholders and refund actual overcharges.

Findings

The Examiners' findings include apparent violations of failure to file underwriting rate related rules and supplemental rate information; the failure to file the classification of UW/Credit tiers in the assignment of different Mkt tiers between policyholders with like UW and Credit tiers between Companies.

Failed to File Supplemental Rate Information on U/W and Credit Tiering

The Company failed to file pertinent supplemental rate information that had a direct impact on the rating process in developing the assigned Credit tiers and Mkt tiers from January 2001 to its December 2003 rate filings. The Company also failed to provide these documents to the Examiners until the latter part of the examination: The Company:

- Failed to file the actual credit score ranges and their corresponding credit tier designators.
- Failed to file its Mkt Determination Tables. These tables are a direct correlation to the Company's rating methodology and govern how the Company intended to combine its UW Tiers with its Credit Tiers to produce its specific Mkt tiers.

Failure to File Amendments to Rate Related Underwriting Rules

Progressive failed to identify changes to its rate related underwriting rules with its June of 2001 and October 2002 rate filings.

The rule guidelines provided to the Examiners were different than the rule guidelines provided to the Division. The Company provided the Examiners a full set of guidelines for the time frame of the examination that contained the table of

contents, primary subject headings and numbered pages. The guidelines provided to the examiners as submitted to the Division are devoid of the table of contents and do not contain numbered pages. The examiners reviewed the Company's rate filings in relationship to the provisions of New Mexico statutes requiring companies to file all changes and amendments of all rates and supplementary rate information pursuant to NMSA (1978) § 59A-17-9. The examiners analysis of the Company's compliance with state statute revealed the following facts:

Progressive, in its December 2000 rate filing amended its rating rules and underwriting rate related rules, by supplying the Division with a document titled "Amendments to Rule Guide Filing," which listed, by subject, the changes that had occurred in the rule guidelines since the last filing.

After the December 2000 rate filing the Company failed to identify rate related rule changes. With Progressives' June of 2001 rate filing the Company identified rule changes concerning remarketing rules but failed to identify a rate related rule concerning the acceptability of certain prior carriers.

Progressives' pre-June 2001 underwriting rule acknowledged its subsidiaries as acceptable prior carriers only when the insureds qualified for the UL and PR Mkt tiers. The June 2001 filing removed the acceptability of Progressive as a prior carrier for even the UL and PR Mkt Tiers unless there had been a lapse in coverage from the old policy to the new policy. The rule change prohibits the applicant from obtaining a UW tier better than a C1.

Progressive failed to identify any amendments to its rules in its October 2002 Division filing. The Company failed to identify three rate-related changes:

- The Company had removed the mobile homeowner discount.
- The Company had removed an Anti-theft (recovery device) discount,
- The Company had changed the acceptable prior carrier definition to eliminate Progressive as an acceptable prior carrier even with a lapse in coverage.

Of 400 files reviewed, the examiners found 15 files (or 4%) where policyholders were adversely affected in rate due to the Company's unnoted changes in its rate related rules. The Company did not grandfather renewal business from the rate related rule changes and therefore renewal policyholders lost long standing credits.

In conclusion, the examiners determine the Company's actions to be an apparent violation of NMSA (1978) § 59A-17-9. The Company disagreed with the alleged violation as the Company at all times treated policyholders in accordance with their approved filings. The Company agreed to provide whatever notice the Division wishes when rate related rule changes are made.

Classification and Company Consolidation

Progressive did not follow its filing in the classification and rating of consolidated renewal policies. In order to prevent rate shock, the policies were assigned financial responsibility tiers and underwriting tiers which most closely matched their current rate.

The Company's actions and practices result in apparent violations of NMSA (1978) §§ 59A-17-9.

Bucket Underwriting/ Rating Findings

The examiners reviewed 375 PPIC, PCIC, PNIC, CIC, and PHIC policies and found nine policies where the Company failed to follow its filings. The Company had:

- a. Failed to assign the correct U/W tiers on three policies: CLNB078, CLNB060 and CLNB057.
- b. Failed to assign the correct Credit Score and Credit tiers on three policies: PRNB014, CLNB075 and CLNB064.
- c. Failed to remarket policyholder NONB079 effective November 27, 2003 when the policyholder was eligible for remarketing.
- d. Remarketed two policyholders, PRNB060 and NONB080, when the insureds did not qualify due to 5 days lapse of coverage between terms pursuant to the Company's written guidelines.

In conclusion, the Company's actions are an apparent violation of NMSA (1978) § 59A-17-9.

No Hits and Thin Files

The examiners' reviewed the Company's U/W and Credit tier assignments for insureds who either have no consumer credit reports (classified as "No Hits") or insureds who have had very little credit history, (i.e. inquiries only; or "Thin Files"). During the course of the examination, the Company provided data supporting the classification of no hits and thin files consistent with the

Company's finding that individuals with little or no credit history pose a greater than average risk of loss.

Scoring/Ranges & Algorithms

The examiners reviewed the Company's application, use, and accuracy of its credit based scoring model in relationship to the Company guidelines and New Mexico State Statutes NMSA (1978) § 59A-17-9. The examiners review revealed the following:

Progressive uses its own *"proprietary credit score algorithm"* to develop individual credit scores (financial responsibility scores) that are used in selecting the marketing, underwriting and rating tiers for both new and renewal business. The Company uses Experian, a third-party vendor, to obtain an applicant's Credit Report and then runs key financial variables through its own Credit Scoring Model to develop an individual's credit score. From the commencement of the Examination until January 2004, Progressive used the same algorithm for all of its Companies in developing the individual credit scores. The Company's "proprietary" Model is called: "Progressive's P01 Primary Credit Scoring Algorithm." This P01 Scoring Model assigned points using 16 financial variables that are based on specific characteristics, ranges, values set and weights within the Model. The cumulative total of all points are multiplied by a fixed factor of 2.369 which is then added to a fixed constant of 752; the resultant sum is the individual's "credit score." Progressive uses the term "financial responsibility score" to be synonymous with credit score; the examiners have used the term "credit score" to minimize confusions. The score is then assigned the Credit Tier

(A1 – R1) which is an alphanumeric label linking it to pre-defined (*unfiled*) set of score band ranges; the lower scores are a more favorable risk; the higher the score, the least favorable the risk.

Score range bands have changed several times within the scope of this Examination. The bands and ranges also vary depending upon what Rating Plan the Company uses. The score bands and corresponding ranges are at the very heart of the Company's pricing structure. These calculations directly affect the scores used and the rating tiers applied on all new and renewal policies.

After the review of the Company's December 2003 Rate Filing, it became evident that two different algorithms were being used to generate credit scores. It also became evident to the examiners that there were differences between the two scoring engines, both in the mathematical functions performed by the algorithm and the set of variables and values used as financial standards from a consumers' credit history report.

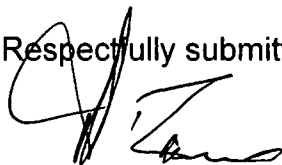
Unlike the earlier algorithm (P01 Primary Credit Scoring Algorithm), the new calculation does away with seven of the 16 variables used to develop the financial score (i.e. *trades most recent 30 days past due; derogatory public records count; bank trades 30 days past due*). Of the remaining nine, the Company has added three new variables: *age of person when earliest reported trade opened within 12 months, number of trade lines opened and month since most recent bank revolving*, for a total of 12 characteristics, in lieu of the previous 16 characteristics. The second change is the actual mathematical calculation itself; the Company has done away with the multiplier and the fixed constant of

752. The new calculation pivots from a base score of 100 to which it adds or subtracts points developed from the queries that made up the 12 characteristics referred to above. The highest possible score range under this new methodology is 156 +, where as under the other Credit Scoring Algorithm, the score ranges climbed as high as 1000+.

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Respectfully submitted,

A handwritten signature in black ink, appearing to read 'N. Romero', written over a horizontal line.

Nestor J. Romero, CPA, CFE, CIE
Examiner in Charge