

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

**PUBLIC REPORT OF THE TARGETED MARKET CONDUCT  
EXAMINATION OF**

**STATE FARM GENERAL INSURANCE COMPANY  
NAIC # 25151 CDI # 1714-5**

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

**AS OF MAY 31, 2014**

**ADOPTED JANUARY 22, 2015**

**STATE OF CALIFORNIA**



**CALIFORNIA DEPARTMENT OF INSURANCE  
MARKET CONDUCT DIVISION  
FIELD CLAIMS BUREAU**

## NOTICE

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

## TABLE OF CONTENTS

<b>SALUTATION.....</b>	<b>1</b>
<b>FOREWORD .....</b>	<b>2</b>
<b>SCOPE OF THE EXAMINATION .....</b>	<b>4</b>
<b>EXECUTIVE SUMMARY OF CLAIMS SAMPLE REVIEWED .....</b>	<b>6</b>
<b>RESULTS OF REVIEWS OF CONSUMER COMPLAINTS AND INQUIRIES AND PREVIOUS EXAMINATIONS.....</b>	<b>7</b>
<b>DETAILS OF THE CURRENT EXAMINATION.....</b>	<b>8</b>
<b>TABLE OF TOTAL ALLEGED VIOLATIONS .....</b>	<b>10</b>
<b>TABLE OF ALLEGED VIOLATIONS BY LINE OF BUSINESS.....</b>	<b>11</b>
<b>SUMMARY OF EXAMINATION RESULTS.....</b>	<b>12</b>

**DEPARTMENT OF INSURANCE**

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



January 22, 2015

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

Honorable Commissioner:

Pursuant to instructions, and under the authority granted under Part 2, Chapter 1, Article 4, Sections 730, 733, 736, and Article 6.5, Section 790.04 of the California Insurance Code; and Title 10, Chapter 5, Subchapter 7.5, Section 2695.3(a) of the California Code of Regulations, an targeted examination was made of the claims handling practices and procedures in California of:

**State Farm General Insurance Company  
NAIC # 25151**

**Group NAIC # 0176**

Hereinafter, the Company listed above also will be referred to as SFGIC or the Company.

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

## FOREWORD

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

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

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

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

## SCOPE OF THE EXAMINATION

To accomplish the foregoing, the examination included:

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

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

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

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

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

The review of the sample of individual claim files was conducted at the offices of the Company in Irvine, California.



## EXECUTIVE SUMMARY OF CLAIMS SAMPLE REVIEWED

The Homeowner and Commercial Property first-party claims reviewed were closed from June 1, 2013 through May 31, 2014, referred to as the "review period". The Homeowner claims populations were comprised of closed paid claims with both dwelling and personal property losses, and closed paid claims with personal property losses only. The Commercial Property claims populations were comprised of closed paid claims with both building and business personal property losses, and closed paid claims with business personal property only. The examiners randomly selected 70 Homeowner claim files and 70 Commercial Property claim files for examination from these populations.

The examiners cited 78 alleged claims handling violations of the California Insurance Code and the California Code of Regulations from this sample file review. The examination found that:

- The Company's claim files did not include evidence that condition was considered and used in the calculation of depreciation deducted from the identified claim files except in certain limited cases in which condition was considered for part of the claim.
- The Company failed to fully explain the basis for adjustments for depreciation to claimants in writing, which must reflect a measurable difference in market value attributable to the condition and age of the property.

## **RESULTS OF REVIEWS OF CONSUMER COMPLAINTS AND INQUIRIES AND PREVIOUS EXAMINATIONS**

The Company was the subject of 189 California consumer complaints and inquiries related to Homeowner and Commercial Property first-party claims closed from June 1, 2013 through May 31, 2014. Within these 189 complaints, the CDI alleged 19 violations of law and determined 13 complaints were justified. The violations of law did not pertain to the depreciation practices of the Company.

The Company was the subject of a prior targeted examination that focused on the claims and underwriting practices and procedures related to structural total loss claims that occurred as a result of the 2007 California wildfires. The Homeowner claims reviewed were opened from June 25, 2007 through December 11, 2007. Depreciation was not a specific focus of the 2007 examination, and there were no findings related to depreciation in this examination.

The Company was also the subject of a prior regularly scheduled claims examination that reviewed claims closed during the period of October 16, 2007 through October 15, 2008. Depreciation practices were not specifically targeted in the examination, and no findings related to depreciation were noted.

## DETAILS OF THE CURRENT EXAMINATION

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

<b>SFGIC SAMPLE FILES REVIEW</b>			
<b>LINE OF BUSINESS / CATEGORY</b>	<b>CLAIMS IN REVIEW PERIOD</b>	<b>SAMPLE FILES REVIEWED</b>	<b>NUMBER OF ALLEGED VIOLATIONS</b>
Homeowner Multiple Peril / *Homeowners; Renters; Condominium Unit Owners; Manufactured Home / First Party	22,114	70	68
Commercial Property / *Farm and Ranch; Boat Owners; Flood; Commercial Multiple Peril (CMP)-Contractors; CMP-Miscellaneous Business; CMP-Business, Office; CMP-Condominium; CMP-Apartment; CMP-Church; CMP-Business, Service and Mercantile; Personal Articles; Specialty Earthquake and Earthquake; Personal Liability Umbrella; Commercial-Bond, Crop Hail / First Party	5,679	70	10
<b>TOTALS</b>	27,793	140	78

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

Of the 70 Homeowner claims reviewed, 36 did not involve depreciation and 34 were subject to depreciation. The 36 Homeowner claims with no depreciation involved the following: negotiated amounts or no reasons provided by the Company for not applying depreciation; mitigation/emergency services; claims subject to limits (e.g. jewelry, cash, business property limit, etc.); item(s) replaced prior to payment of the claim; repairs only; or the item was new. Depreciation is not applicable to these claims. Other than one manufactured home claim randomly selected for review, it was noted that the Company took no depreciation when adjusting losses involving the structure. Based on information provided by State Farm for the examination, the Company has

taken no depreciation on structures insured under Homeowner policies since March 15, 1997.

Of the 70 Commercial Property claims reviewed, 64 did not involve depreciation and six were subject to depreciation. The 64 Commercial Property claims with no depreciation included 47 Personal Articles Protection (PAP) claims. The Company categorizes and includes PAP policies in the Commercial line of business. Depreciation is not applicable to these types of claims. The remainder of the claims involved claims subject to limits; repairs only; negotiated amounts or no reasons provided by the Company for not applying depreciation; mitigation/emergency services; or business property inventories. Depreciation is also not applicable to the remainder of these claims.

## TABLE OF TOTAL ALLEGED VIOLATIONS

Citation	Description of Allegation	SFGIC Number of Alleged Violations
CIC §§ 2051 and 2051.5/CCR §2695.9(f) *[CIC §790.03(h)(3)]	The Company failed to document in the claim file all justification for the adjustment of the amount claimed because of betterment, depreciation, or salvage. Any adjustment for betterment or depreciation shall reflect a measurable difference in market value attributable to the condition and age of the property.	38
CCR §2695.9(f) *[CIC §790.03(h)(3)]	The Company failed to fully explain the basis for any adjustment to the claimant in writing.	40
<b>Total Number of Citations</b>		<b>78</b>

### \*DESCRIPTONS OF APPLICABLE UNFAIR CLAIMS SETTLEMENT PRACTICES

CIC §790.03(h)(3)	The Company failed to adopt and implement reasonable standards for the prompt investigation and processing of claims arising under insurance policies.
-------------------	--------------------------------------------------------------------------------------------------------------------------------------------------------

**TABLE OF ALLEGED VIOLATIONS BY LINE OF BUSINESS**

<b>HOMEOWNER</b> 2013 Written Premium: \$1,487,506,177	<b>NUMBER OF ALLEGED VIOLATIONS</b>
<b>AMOUNT OF RECOVERIES</b> <b>\$0.00</b>	
CIC §§ 2051 and 2051.5/CCR §2695.9(f) [CIC §790.03(h)(3)]	33
CCR §2695.9(f) [CIC §790.03(h)(3)]	35
<b>SUBTOTAL</b>	<b>68</b>

<b>COMMERCIAL PROPERTY</b> *2013 Written Premium: \$322,572,397	<b>NUMBER OF ALLEGED VIOLATIONS</b>
<b>AMOUNT OF RECOVERIES</b> <b>\$0.00</b>	
CIC §§ 2051 and 2051.5/CCR §2695.9(f) [CIC §790.03(h)(3)]	5
CCR §2695.9(f) [CIC §790.03(h)(3)]	5
<b>SUBTOTAL</b>	<b>10</b>

\*Premium from the annual statement for the following lines of business: Fire, Allied lines, Farm owners, Commercial multiple peril, Inland marine, and Earthquake.

<b>TOTAL</b>	<b>78</b>
--------------	-----------

## SUMMARY OF EXAMINATION RESULTS

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

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

### HOMEOWNERS' PROPERTY INSURANCE CLAIMS (HOMEOWNER)

1. In 33 claim files reviewed, the Company's claim file failed to contain all justification for the adjustment of the amounts claimed because of betterment, depreciation or salvage, and the adjustments failed to reflect a measurable difference in market value attributable to the condition, in addition to the age of, the property. Thirty-two instances pertain to the depreciation of personal property. One instance pertains to the depreciation of the dwelling on a manufactured home policy. In the files reviewed, the following situations were observed. The number of instances identified below total more than 33, as some claim files include more than one of the described situations.

- a) In 32 instances related to personal property, during the review period State Farm made available its Personal Property Inventory Form (PPIF) to assist the insured. The information obtained from the insured on the PPIF is used to generate the Contents Inventory Summary that State Farm used as its written explanation for the basis of depreciation. The PPIF does not include a column pertaining to condition. It includes columns for the quantity, detailed description of item, brand name/model number and/or specifications, where purchased or obtained, age of item, today's repair cost/replacement cost/amount of loss (without tax) and documentation available. Additionally, the instructions attached to the form do not include any direction related to the inclusion of the condition of the items when completing the form. Although an initial letter to the insured included instructions to provide information related to the items' condition as of the date of loss in four of the 32 instances, as noted above, this instruction was not on the actual form.
- b) In 19 instances, the files include a reference to condition or a standard notation explaining to the insured that depreciation is a deduction from

replacement cost based on age, condition, quality and use. However, in practice, the notes do not include the specifics of the actual condition of all personal property. For most of the personal property subject to depreciation, the files support a line by line deduction based on age alone.

- c) In seven instances, the file notes include documentation related to the condition of some of the personal property items, but not to all of the personal property subject to depreciation.
- d) In seven instances, no letters or standard notes could be located addressing condition as a component to the depreciation taken on the claim.
- e) In three instances, the Company applied an arbitrary percentage of depreciation to all personal property and there is no evidence condition was considered in the calculation of the depreciation percentage taken.
- f) In three instances, the settlement letter includes language that depreciation is a deduction from replacement cost based on age, condition, quality and use of the property at the time of loss. However, the file does not provide evidence that condition was used in the calculation of depreciation.
- g) In one instance, the insured provided a list of personal property with a column that included the condition of each item being claimed in the loss. Although the Company indicated the information provided by the insured was considered during its evaluation, the file does not contain evidence that condition was considered. Rather, depreciation was based on age only for most of the personal property.

The Department alleges these acts are in violation of CIC §§ 2051 and 2051.5, and CCR §2695.9(f), and are unfair practices under CIC §790.03(h)(3). Specifically, there is no evidence that State Farm used condition in the calculation of the depreciation deducted in these claims, except in certain limited cases, as described above, in which condition was considered for part of the claim.

**Summary of the Company's Response:** In all instances, the Company responded as follows:

The Company does not agree. State Farm complied with CCR §2695.9(f) by providing the policyholder with a Contents Inventory Summary that details the replacement cost, depreciation applied and actual cash value of each item claimed based on information provided by the policyholder, which included age and condition based on discussions with the policyholder as noted above. The Contents Inventory Summary contained



in the claim file reflects adjustments that are discernable, measurable, itemized, and specified as to dollar amount, and accurately reflect the value of the betterment or depreciation. The basis for any adjustment was fully explained to the policyholder in writing when we provided the policyholder with a copy of the Contents Inventory Summary.

The policyholder is the person most knowledgeable about the age, use and condition, and quality of the items being claimed. The file notes reflect the claim handler discussed depreciation to be applied based on the age and use/condition of the items and reached agreement with the policyholder. In our opinion, agreement with a policyholder reflects an accurate adjustment and measurable difference in market value attributable to the use/condition and age of the property...

The Company's response to the instance involving dwelling depreciation on the manufactured home is the same as above, except in place of the Contents Inventory Summary, the Company references the vendor structural estimate (Xactimate).

State Farm also stated that effective May 19, 2014, prior to the commencement of this examination, the Company began using XactContents, the program for personal property by the Company's vendor, Xactware, in place of its internally created PPIF described in item 1(a) above. Using XactContents, the insured is now able to input items into a Personal Property Inventory Customer Worksheet on-line or in written form, which produces the XactContents reports. This inventory process enables the insured to input the quantity, detailed description of the item, brand name/model number and/or specifications, age of the item, use of the item (i.e., heavy, normal, or light) and today's repair cost/replacement cost/amount of loss.

Following the examination, the Company stated that it instructed its vendor Xactware to initiate new programming regarding the factors affecting the amount of depreciation deducted. Instead of the factor and heading entitled "USE" (included in the program since May 19, 2014), State Farm instructed Xactware to utilize a factor and heading for "CONDITION". The Company further instructed Xactware to revise the definitions from the use-related descriptions of "Heavy", "Normal" and "Light", to the condition-related descriptions of "Below Avg.", "Average", and "Above Avg.". The same changes are being made for dwelling estimates for manufactured homes (the only type to which depreciation is applied). The Company stated the programming will be complete and the revised reports ready for implementation in November of 2014.

The Company further disputes the conclusion that condition was not considered, and believes there is no need to remediate past claims.

**Summary of the Department's Evaluation of the Company's Response:**  
Regardless of the discussion that may or may not have taken place with the insured, the justification in the file of depreciation taken is required to include sufficient itemization of

the amounts deducted and the reasons for doing so. The adjustments are required to be discernible, measurable, itemized, and specific as to dollar amount, must accurately reflect the value of the betterment, depreciation or salvage, and must take into consideration condition and age of the item. While the Department recognizes the Contents Inventory Summary and estimates include a line by line itemization providing the amounts deducted for depreciation, the inventories and estimates did not include information regarding the age, condition and useful life of the property. No other information was contained in the files to demonstrate that State Farm had considered the condition of each item when applying depreciation.

The revisions the Company has proposed to its inventory process and vendor reports for implementation as of November 2014 appear to allow for consideration of the condition of items in determining the amount of depreciation to apply. The Department will continue to evaluate how the Company applies this process. The Company's response does not address reimbursement for claimants whose claims were adjusted for depreciation without considering the condition of each item.

**2. In 35 instances, the Company failed to fully explain the basis for any adjustment to the claimant in writing.** Thirty-four instances pertain to the depreciation of personal property. One instance pertains to the depreciation of the dwelling on a manufactured home policy. The information provided by State Farm does not demonstrate that the Company has provided claimants with written explanation of the basis for depreciation in these claim files. Although a copy of the Contents Inventory Summary and settlement letter were provided to the insured in most instances pertaining to personal property, the inventory and letter do not fully explain the basis for depreciation, which must reflect a measurable difference in market value attributable to the condition and age of the property. The inventory details the replacement cost, depreciation percentage, depreciation amount applied and actual cash value of each item. It does not include the age, condition or useful life of the items depreciated.

Additionally, in two of the instances pertaining to the depreciation of personal property and in the instance pertaining to the depreciation of the dwelling on a manufactured home policy, the written settlement letter stated the "loss has been adjusted to actual cash value in accordance with the terms of your policy. Actual cash value is replacement cost less depreciation. Depreciation is a deduction from the replacement cost based on age, condition, quality, and use of the property at the time of the loss." While this letter describes the definition of depreciation, the letter does not provide, in writing, the basis of the depreciation taken to the items in the specific claim to include both condition and age.

In the instance pertaining to the dwelling covered under a manufactured home policy, a copy of the Xactimate structural estimate was sent to the insured; however, the estimate did not provide a written explanation for the basis of the depreciation taken, which must reflect a measurable difference in market value attributable to the condition and age of the property. The estimate details the replacement cost, depreciation

amount applied and actual cash value of each structural component. It does not include the age, condition or useful life of the items depreciated.

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

**Summary of the Company's Response:** In all instances regarding personal property, the Company stated the following in response:

The Company does not agree. State Farm complied with CCR §2695.9(f) by providing the policyholder with a Contents Inventory Summary that details the replacement cost, depreciation applied and actual cash value of each item claimed based on information provided by the policyholder, which included age and condition based on discussions with the policyholder as noted above. The Contents Inventory Summary contained in the claim file reflects adjustments that are discernable, measurable, itemized, and specified as to dollar amount, and accurately reflect the value of the betterment or depreciation. The basis for any adjustment was fully explained to the policyholder in writing when we provided the policyholder with a copy of the Contents Inventory Summary.

The policyholder is the person most knowledgeable about the age, use and condition, and quality of the items being claimed. The file notes reflect the claim handler discussed depreciation to be applied based on the age and use/condition of the items and reached agreement with the policyholder. In our opinion, agreement with a policyholder reflects an accurate adjustment and measurable difference in market value attributable to the use/condition and age of the property...

The Company's response to the instance involving dwelling depreciation on the manufactured home is the same as above, except that in place of the Contents Inventory Summary the Company references the vendor structural estimate (Xactimate).

State Farm also stated that effective May 19, 2014, prior to the commencement of this examination, the Company began using XactContents, the program for personal property by the Company's vendor, Xactware, in place of its internally created Contents Inventory Summary. Using XactContents, the insured is now able to input items into a Personal Property Inventory Customer Worksheet on-line or in written form, which produces the XactContents reports. This inventory enables the insured to input the quantity, detailed description of the item, brand name/model number and/or

specifications, age of the item, use of the item (i.e., Heavy, normal, or light) and today's repair cost/replacement cost/amount of loss.

Following the examination, the Company stated that it instructed its vendor Xactware to initiate new programming regarding the factors affecting the amount of depreciation deducted. Instead of the factor and heading entitled "USE" (included in the program since May 19, 2014), State Farm instructed Xactware to utilize a factor and heading for "CONDITION". The Company further instructed Xactware to revise the definitions from the use-related descriptions of "Heavy", "Normal" and "Light", to the condition-related descriptions of "Below Avg.", "Average", and "Above Avg.". The same changes are being made for dwelling estimates for manufactured homes (the only type to which depreciation is applied). A printed report containing the data points described will be provided to the claimant to serve as a written explanation of the basis for the depreciation taken. The Company stated the programming will be complete and the revised reports ready for implementation in November of 2014.

**Summary of the Department's Evaluation of the Company's Response:** The Department recognizes the Contents Inventory Summary, in use during the examination review period, includes a line by line itemization providing the amounts deducted for depreciation as well as the depreciation percentage. However, the inventories did not include the age, condition and useful life of the personal property subject to depreciation. With regard to the instance pertaining to dwelling depreciation, this also does not provide detail pertaining to the age, condition and useful life of the structural components subject to depreciation. No other additional correspondence that explained the basis for any adjustment in writing was sent to the insured.

Regardless of the method the Company uses to provide a written explanation, such as the settlement letter, the Contents Inventory Summary or the computerized estimate implemented as of May 19, 2014, the explanation is required to include sufficient itemization of the amounts deducted and the reasons for doing so. The adjustments are required to be discernible, measurable, itemized and specific as to dollar amount, must accurately reflect the value of the betterment, depreciation or salvage, and must take into consideration condition and age.

The revisions the Company has proposed to its inventory process and vendor reports for implementation as of November 2014 appear to allow for appropriate written explanation to the claimant of the adjustment made, taking into account both the condition and the age of items depreciated; the application of this process will continue to be evaluated by the Department.

## **COMMERCIAL PROPERTY INSURANCE CLAIMS**

**3. In five claim files reviewed, the Company's claim file failed to contain all justification for the adjustment of the amounts claimed because of betterment,**

**depreciation or salvage, and the adjustments failed to reflect a measurable difference in market value attributable to the condition, in addition to the age of, the property.** All instances pertain to the depreciation of business personal property. In the files reviewed, the following situations were observed. The number of instances identified below total more than five, as some claim files include more than one situation.

- a) In all five instances, State Farm made available its Personal Property Inventory Form (PIIF) to assist the insured. The PIIF does not include a column pertaining to condition. It includes columns for the quantity, detailed description of item, brand name/model number and/or specifications, where purchased or obtained, age of item, today's repair cost/replacement cost/amount of loss (without tax) and documentation available. Additionally, the instructions attached to the form do not include any direction related to the inclusion of the condition of the items when completing the form. Although an initial letter to the insured included instructions to provide information related to the items' condition as of the date of loss in four of the five instances, as noted above, this instruction was not on the actual form.
- b) In two instances, the files include reference to condition or a standard notation explaining to the insured that depreciation is a deduction from replacement cost based on age, condition, quality and use. However, in practice, the notes do not include the specifics of the actual condition of all business personal property. For most of the business personal property subject to depreciation, the files support a line by line deduction based on age alone.
- c) In one instance, the file notes include documentation related to the condition of some of the business personal property items, but not to all of the business personal property subject to depreciation.
- d) In one instance, the settlement letter includes language that depreciation is a deduction from replacement cost based on age, condition, quality and use of the property at the time of loss. However, the file does not provide evidence that condition was used in the calculation of depreciation.

The Department alleges these acts are in violation of CIC §§ 2051 and 2051.5, and CCR §2695.9(f), and are unfair practices under CIC §790.03(h)(3). Specifically, there is no evidence that State Farm used condition in the calculation of the depreciation deducted in these claims, except in certain limited cases in which condition was considered for part of the claim.

**Summary of the Company's Response:** In all instances, the Company responded as follows:

The Company does not agree. State Farm complied with CCR §2695.9(f) by providing the policyholder with a Contents Inventory Summary that details the replacement cost, depreciation applied and actual cash value of each item claimed based on information provided by the policyholder, which included age and condition based on discussions with the policyholder as noted above. The Contents Inventory Summary contained in the claim file reflects adjustments that are discernable, measurable, itemized, and specified as to dollar amount, and accurately reflect the value of the betterment or depreciation. The basis for any adjustment was fully explained to the policyholder in writing when we provided the policyholder with a copy of the Contents Inventory Summary.

The policyholder is the person most knowledgeable about the age, use and condition, and quality of the items being claimed. The file notes reflect the claim handler discussed depreciation to be applied based on the age and use/condition of the items and reached agreement with the policyholder. In our opinion, agreement with a policyholder reflects an accurate adjustment and measurable difference in market value attributable to the use/condition and age of the property...

State Farm also stated that effective May 19, 2014, prior to the commencement of this examination, the Company began using XactContents, the program for personal property by the Company's vendor, Xactware, in place of its internally created PPIF described in item 3(a) above. Using XactContents, the insured is now able to input items into a Personal Property Inventory Customer Worksheet on-line or in written form, which produces the XactContents reports. This inventory process enables the insured to input the quantity, detailed description of the item, brand name/model number and/or specifications, age of the item, use of the item (i.e., heavy, normal, or light) and today's repair cost/replacement cost/amount of loss.

Following the examination, the Company stated that it instructed its vendor Xactware to initiate new programming regarding the factors affecting the amount of depreciation deducted from business personal property and commercial buildings. Instead of the factor and heading entitled "USE" (included in the program since May 19, 2014), State Farm instructed Xactware to utilize a factor and heading for "CONDITION". The Company further instructed Xactware to revise the definitions from the use-related descriptions of "Heavy", "Normal" and "Light", to the condition-related descriptions of "Below Avg.", "Average", and "Above Avg.". The Company stated the programming will be complete and the revised reports ready for implementation in November of 2014.

The Company further disputes the conclusion that condition was not considered, and believes there is no need to remediate past claims.

#### **Summary of the Department's Evaluation of the Company's Response:**

Regardless of the discussion that may or may not have taken place with the insured, the justification in the file of depreciation taken is required to include sufficient itemization of the amounts deducted and the reasons for doing so. The adjustments are required to be discernible, measurable, itemized, and specific as to dollar amount, must accurately reflect the value of the betterment, depreciation or salvage, and must take into consideration condition and age of the item. While the Department recognizes the Contents Inventory Summary and estimates include a line by line itemization providing the amounts deducted for depreciation, the inventories and estimates did not include information regarding the age, condition and useful life of the property. No other information was contained in the files to demonstrate that State Farm had considered the condition of each item when applying depreciation.

The revisions the Company has proposed to its inventory process and vendor reports for implementation as of November 2014 appear to allow for consideration of the condition of items in determining the amount of depreciation to apply. The Department will continue to evaluate how the Company applies this process. The Company's response does not address reimbursement for claimants whose claims were adjusted for depreciation without considering the condition of each item.

**4. In five instances, the Company failed to fully explain the basis for any adjustment to the claimant in writing.** All instances pertain to the depreciation of business personal property. The information provided by State Farm does not demonstrate that the Company has provided claimants with written explanation of the basis for depreciation in these claim files. Although a copy of the Contents Inventory Summary and settlement letter were provided to the insured in most instances, the inventory and letter do not fully explain the basis for depreciation, which must reflect a measurable difference in market value attributable to the condition and age of the property. The inventory details the replacement cost, depreciation percentage, depreciation amount applied and actual cash value of each item. It does not include the age, condition or useful life of the items depreciated.

In one of the instances pertaining to the depreciation of business personal property, the written settlement letter stated the "loss has been adjusted to actual cash value in accordance with the terms of your policy. Actual cash value is replacement cost less depreciation. Depreciation is a deduction from the replacement cost based on age, condition, quality, and use of the property at the time of the loss." While this letter describes the definition of depreciation, the letter does not provide, in writing, the basis of the depreciation taken to the items in the specific claim to include both condition and age.

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

**Summary of the Company's Response:** In all instances, the Company responded as follows:

The Company does not agree. State Farm complied with CCR §2695.9(f) by providing the policyholder with a Contents Inventory Summary that details the replacement cost, depreciation applied and actual cash value of each item claimed based on information provided by the policyholder, which included age and condition based on discussions with the policyholder as noted above. The Contents Inventory Summary contained in the claim file reflects adjustments that are discernable, measurable, itemized, and specified as to dollar amount, and accurately reflect the value of the betterment or depreciation. The basis for any adjustment was fully explained to the policyholder in writing when we provided the policyholder with a copy of the Contents Inventory Summary.

The policyholder is the person most knowledgeable about the age, use and condition, and quality of the items being claimed. The file notes reflect the claim handler discussed depreciation to be applied based on the age and use/condition of the items and reached agreement with the policyholder. In our opinion, agreement with a policyholder reflects an accurate adjustment and measurable difference in market value attributable to the use/condition and age of the property...

State Farm also stated that effective May 19, 2014, prior to the commencement of this examination, the Company began using XactContents, the program for business personal property by the Company's vendor, Xactware, in place of its internally created Contents Inventory Summary. Using XactContents, the insured is now able to input items into a Personal Property Inventory Customer Worksheet on-line or in written form, which produces the XactContents reports. This inventory enables the insured to input the quantity, detailed description of the item, brand name/model number and/or specifications, age of the item, use of the item (i.e., Heavy, normal, or light) and today's repair cost/replacement cost/amount of loss.

Following the examination, the Company stated that it instructed its vendor Xactware to initiate new programming regarding the factors affecting the amount of depreciation deducted. Instead of the factor and heading entitled "USE" (included in the program since May 19, 2014), State Farm instructed Xactware to utilize a factor and heading for "CONDITION". The Company further instructed Xactware to revise the definitions from the use-related descriptions of "Heavy", "Normal" and "Light", to the condition-related descriptions of "Below Avg.", "Average", and "Above Avg.". A printed report containing the data points described will be provided to the claimant to serve as a written explanation of the basis for the depreciation taken. The Company stated the programming will be complete and the revised reports ready for implementation in November of 2014.



**Summary of the Department's Evaluation of the Company's Response:** The Department recognizes the Contents Inventory Summary, in use during the examination review period, includes a line by line itemization providing the amounts deducted for depreciation as well as the depreciation percentage. However, the inventories did not include the age, condition and useful life of the business personal property subject to depreciation. No other additional correspondence that explained the basis for any adjustment in writing was sent to the insured.

Regardless of the method the Company uses to provide a written explanation, such as the settlement letter, the Contents Inventory Summary, or the computerized estimate implemented as of May 19, 2014, the explanation is required to include sufficient itemization of the amounts deducted and the reasons for doing so. These adjustments are required to be discernible, measurable, itemized and specific as to dollar amount, must accurately reflect the value of the betterment, depreciation or salvage, and must take into consideration condition and age.

The revisions the Company has proposed to its inventory process and vendor reports for implementation as of November 2014 appear to allow for appropriate written explanation to the claimant of the adjustment made, taking into account both the condition and the age of items depreciated; the application of this process will continue to be evaluated by the Department.