

**BEFORE THE INSURANCE COMMISSIONER
FOR THE STATE OF ARKANSAS**

**IN THE MATTER OF
THE REPORT OF EXAMINATION
OF STATE AUTO PROPERTY AND
CASUALTY INSURANCE COMPANY
AND STATE AUTOMOBILE MUTUAL
INSURANCE COMPANY**

A.I.D. NO. 2013- 067

ADOPTION ORDER

Now on this day the matter of the Report of Examination (“Report”) of State Auto Property and Casualty Insurance Company, NAIC No. 25127, and State Automobile Mutual Insurance, NAIC No. 25135, (collectively “Companies”), of Columbus, Ohio, is taken under consideration by Jay Bradford, Insurance Commissioner for the State of Arkansas (“Commissioner”), as presented by Associate Counsel, Amanda Capps Rose, and the Finance Division of the Arkansas Insurance Department (“Department”). From the facts, matters and other things before him, the Commissioner finds as follows:

FINDINGS OF FACT

1. The Commissioner has jurisdiction over the Company and the subject matter involved herein.
2. The Companies are domiciled in Ohio and authorized to write property and casualty business in Arkansas.
3. Pursuant to Ark. Code Ann. §§ 23-61-201, *et seq.*, the Commissioner authorized and directed the Department to perform a market conduct examination of the Companies.
4. Said examination was commenced by the Department on October, 18, 2011 and completed on April 16, 2013.

5. The Report was mailed to the Companies on April 23, 2013. The Companies responded on June 10, 2013, and that response has been taken into consideration.

6. Broadstreet Capital Partners, Inc. (“BCP”) was a wholly-owned subsidiary of the Companies prior to March 1, 2012. Effective on or about that date, 85% of BCP was sold to outside investors. State Auto has retained 15% ownership of BCP. Steve Standridge Insurance Agency (“SSI”) was majority-owned by BCP from October 22, 2001 through April 23, 2009, when BCP’s remaining majority interest in SSI was sold to Steve Standridge, SSI’s President. Steve Standridge was an Arkansas-licensed insurance producer and appointed agent of the Companies during that period and subsequent to April 23, 2009 until his producer license suspension on March 3, 2010 as discussed below.

7. On December 27, 2004, SSI provided the Companies’ underwriting department with financial guarantee bonds issued December 16, 2004 by an SSI Arkansas-licensed agent for one insured. State Auto was not aware of these bonds and was never presented with the application for review prior to issuance as required by State Auto’s underwriting procedures.

8. In March 2005, the Companies became aware of a bond issued to a second insured without approval by the Companies. Further, in March 2005, the Companies became aware of a financial guarantee bond issued to third insured. This application was originally presented to the Companies for approval and was declined by the underwriting department.

9. As a result of the unauthorized bond issuances, the Companies suspended the SSI JMR-Fayetteville agency location's bond authority for all bonds in May 2005. At the same time, the Companies began to investigate missing or unused bond numbers assigned to SSI.

10. On August 11, 2005, when the obligee contacted the Companies to confirm coverage, the Companies became aware of a financial guarantee bond issued to a fourth insured, effective June 15, 2005. The Companies had never been presented this bond application by SSI for underwriting approval. This bond issuance also violated the bond moratorium issued in May 2005. No premium was remitted to the Companies on this bond until the Companies became aware of its issuance.

11. On November 21, 2005, the Companies received notice of a claim for eighty thousand dollars (\$80,000) on a bond issued to a fifth insured. The bond was issued on July 11, 2005 by an Arkansas-licensed agent. The bond number assigned to this bond was the same number assigned to another bond issued to a different insured. Upon investigation, the Companies identified six bonds issued to the fifth insured on various dates from August 2004 through September 2005 for approximately three million, two hundred thousand dollars (\$3,200,000) in coverage and premium totaling forty-six thousand, sixty-five dollars (\$46,065). The premium was never remitted to the Companies until they became aware of the bonds.

12. On or about December 15, 2005, the Companies' management determined that no additional action was needed, and that no reporting to the Department was necessary regarding the bond issues.

13. On January 13, 2006, the Companies were given notice of a pending project termination on a bond issued to a sixth insured. The Companies were not aware of the issuance of this bond, which was issued on June 13, 2005, nor were they aware of another bond issued to the same insured on the same date. These were also issued during the bond moratorium and written by an Arkansas-licensed agent. Claims were paid by State Auto on these bonds. None of these actions were reported to the Department.

14. On October 20, 2008, a bond claim from the Missouri Department of Revenue was received for a seventh insured. The bond was issued on April 28, 2006 and was not known to the Companies. Further, another claim from the Missouri Department of Revenue was received on August 14, 2009. This bond was also not known to the Companies. The premiums for these two bonds were never remitted.

15. On April 17, 2009, the Companies received notice from the first premium finance company that SSI had submitted applications for financing insurance policies for two insureds, with premium of approximately one million, seventy thousand dollars (\$1,070,000). Insurance coverage by the Companies was in-force for these two insureds at that time with premium on these policies of approximately fifty-three thousand dollars (\$53,000). The Companies inquired of Steve Standridge on April 17, 2009 about these applications, and he stated that the insureds were expecting government stimulus funds for various construction projects, necessitating the need for substantial new coverage, and thus the insured had requested cancellation and rewrite of the existing policies. Steve Standridge then stated that the insureds had subsequently decided to wait for confirmation of the new construction business before obtaining the additional insurance. Thus, the replacement policies were never issued. On the same day, these transactions

were escalated through the Companies' underwriting department supervisors to the State Auto Southern Regional President, who stated he had never seen such proposed transactions by anyone in his career. BCP's President and Chief Executive Officer was also notified of these events on the same day. The premium finance transactions were never executed, and no replacement policies were ever issued, these fraudulent application submissions were not reported to the Department or any regulatory authorities.

16. The Companies also became aware of a second instance of SSI premium finance fraud on September 22, 2009 when a second premium finance company attempted to confirm general liability coverage for a third insured with coverage effective April 5, 2009. The premium finance agreement was signed on April 8, 2009 for premium of thirty-nine thousand, five hundred seventy-one dollars (\$39,571). The actual policy premium for the existing in-force coverage was four thousand, thirty-nine dollars (\$4,039), and the coverage was later cancelled on February, 12, 2010. The overstated premium finance loan was not reported to the Department or any regulatory authorities.

17. A third instance of premium finance fraud was committed by SSI against a premium finance company. The related premium finance agreement was dated November 17, 2009 for the same insured that purchased financial guarantee bonds, and is referred to as the fourth bond insured noted above.

18. On December 28, 2009, Steve Standridge notified State Auto that the coverage had been replaced by another underwriting company effective December 1, 2009. Thus, the Companies returned premium to SSI of three hundred fifty-four thousand, four hundred and eight dollars (\$354,408) for cancellation of coverage

effective December 1, 2009. The premiums were agency-billed to the premium finance company by SSI, which never remitted the return premium to the premium finance company. When the insured defaulted on the premium finance agreement, the Companies paid the premium finance company two hundred eighty-two thousand, four hundred eighty-eight dollars (\$282,488) on July 30, 2010 for collateralized premiums that were never returned to them by SSI. State Auto became aware of the non-refunded premium to the premium finance company on January 25, 2010. These events were not reported to the Department or any regulatory authorities at any time.

CONCLUSIONS OF LAW

19. The Commissioner has jurisdiction over the parties and the subject matter contained herein.

20. According to Arkansas law, “[a] person engaged in the business of insurance having knowledge or a reasonable belief that a fraudulent insurance act is being, will, be, or has been committed” must provide that information to the Commissioner. Ark. Code Ann. § 23-66-505(a). A “fraudulent insurance act” is defined “an act or omission committed by a person who, knowingly and with intent to defraud, deceive, conceal, or misrepresent... [i]ssues false, fake, or counterfeit insurance policies, certificates of insurance, insurance identification cards, policy declaration pages or policy covers, or insurance binders or other temporary contracts of insurance.” Ark. Code Ann. § 23-66-501(4)(G).

21. Due to the Companies’ failures to report their knowledge or reasonable belief that a fraud was being, or had been, committed, which is a violation of the

Arkansas Insurance Code, they are subject to having their Arkansas Certificates of Authority suspended.

22. This Adoption Order has been properly entered in accordance with the Arkansas Insurance Code and Department Rules.

THEREFORE, pursuant to the provisions of Ark. Code Ann. § 23-61-205 and other provisions of the Arkansas Insurance Code, the Commissioner hereby orders:

1. That the Examination Report, as filed with the Department, is hereby adopted;
2. That the Department shall forward a copy of this Adoption Order and the adopted Examination Report, as filed, to the Companies via certified mail. The mailing to the Company shall include specimen affidavit forms for the Companies' Board of Directors to use in acknowledgement of receipt of the adopted Report of Examination and this Adoption Order;
3. That within twenty (20) days of receipt of this Adoption Order and the adopted Examination Report, the Companies shall file with the Department affidavits executed by each one of its directors, stating under oath or affirmation that each has received a copy of this Adoption Order and the adopted Examination Report;
4. That the adopted Examination Report shall be open for public inspection upon the expiration of thirty (30) days from the Companies' receipt of this Adoption Order;
5. In lieu of suspending the Arkansas Certificates of Authority for the Companies, the Commissioner hereby orders that the Companies pay a fine of forty-five thousand dollars (\$45,000), five thousand dollars (\$5000) for each of the nine (9)

violations of the Arkansas Insurance Code pursuant to Ark. Code Ann. § 23-63-213(c)(1).

IT IS SO ORDERED this 10th day of July, 2013.


JAY BRADFORD
INSURANCE COMMISSIONER
STATE OF ARKANSAS