STATE OF ALASKA
DEPARTMENT OF COMMERCE, COMMUNITY, AND ECONOMIC DEVELOPMENT
DIVISION OF INSURANCE
550 West 7th Avenue, Suite 1560
ANCHORAGE, ALASKA 99501-3567

ORDER # MCE 05-01

In the Matter of the Market Conduct Examination of	)	Order Under the Provisions of AS 21.06.150(b), Approving the Report on Market Conduct Examination.
SeaBright Insurance Company,	)	
Examinee.	)	

The Director of Insurance for the State of Alaska, Linda S. Hall, issues this order adopting the Report of Market Conduct Examination MCE 05-01 of SeaBright Insurance Company (SeaBright), dated June 21, 2005, based upon the following findings:

FINDINGS OF FACT

Finding No. 1.

SeaBright is a non-domiciled insurer writing property and casualty insurance in Alaska and holds Certificate of Authority No. 773 and is subject to examinations pursuant to Alaska Statute (AS) 21.06.120.

Finding No. 2.

The Notice of Examination, which outlined the scope of the examination, was presented to the examinee on February 4, 2005. The primary focus of the examination was to review the company's application of its "Schedule Rating Plan" (SRP) when rating and underwriting workers' compensation insurance.

Finding No. 3.

The Market Conduct Examination was conducted between March 7 and March 11, 2005. Mr. Donald E. Hale, CLU AIE, was the Examiner-in-Charge.

Finding No. 4.

A Report on the Market Conduct Examination of SeaBright in compliance with Alaska statute and matters enumerated in the Notice of Examination was presented to the examinee on June 21, 2005 and filed with the Alaska Division of Insurance in accordance with AS 21.06.150(b).

Finding No. 5.

In accordance with AS 21.06.150(b), SeaBright was afforded the opportunity to respond to the Alaska Division of Insurance concerning matters contained in the Report on Market Conduct Examination. A response was received on July 21, 2005. SeaBright agrees and will comply with the recommendations of the Market Conduct Report. SeaBright's response is appended, and is made a part of the examination report.

Finding No. 6.

The Director of Insurance has fully considered and reviewed to the extent that she considered necessary the Report on Market Conduct Examination, together with the written response of SeaBright, and any relevant portion of the examiner's work papers.

Finding No. 7.

The examination of SeaBright was conducted in accordance with applicable Alaska statutes. The report is a factual account of the findings of the examiners based on tests that determine compliance with Alaska statutes and regulations and supported with appropriate documentation.

CONCLUSIONS OF LAW

Conclusion No. 1.

The examination report was filed with the division and transmitted to SeaBright in accordance with AS 21.06.150(b).

Conclusion No. 2.

An order should be issued in accordance with AS 21.06.150(b) approving the examination report.

ORDER

It is hereby ordered that under AS 21.06.150(b) the attached Report on the Market Conduct Examination of SeaBright (MCE 05-01), dated June 21, 2005, is approved and directed that SeaBright's response be appended and made a part of the examination.

This order is effective December 29, 2005,

Dated this 29th day of December 2005, at Anchorage, Alaska.

Linda S. Hall

Linda S. Hall
Director

STATE OF ALASKA
DEPARTMENT OF COMMUNITY AND ECONOMIC DEVELOPMENT

DIVISION OF INSURANCE

REPORT OF LIMITED MARKET

CONDUCT EXAMINATION

OF

SeaBright Insurance Company
Chicago, Illinois

2101 4th Avenue, Suite 1600, Seattle, Washington 98121
P.O. Box 21868, Seattle Washington 98111

MCE 05-01

Submitted by
Donald E. Hale, CLU
Market Conduct Analyst
June 21, 2005

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Recommended Actions

Recommendation 1) It is recommended that SeaBright review, implement, and/or update policies, procedures and training to ensure that its files contain all notes, papers documents, and similar material, and be in sufficient detail that those relevant events; the dates of those events, and all persons participating in those events can be identified.

Recommendation 2) It is recommended that SeaBright re-file its Loss Cost Multiplier with the Division of Insurance and when doing so review its operational requirements for any changes that may be needed.

Recommendation 3) It is recommended that SeaBright file a new "Schedule Rating Plan" (SRP) with the Division of Insurance and when doing so review its underwriting/rating activities/needs for any changes that The Company would like to submit for regulatory approval.

Recommendation 4) Without proper documentation of the "Schedule Rating Work Sheet," it is difficult for the company to demonstrate the consistent application of credits and debits. Therefore, it is recommended that SeaBrigtht implement policies and procedures that will ensure the proper documentation of all rating decisions made, including the application of schedule debits/credits and increases/decreases to schedule credits/debits. This documentation must include the underwriter's reasoning for the debits or credits applied and refer to supporting file documents.

Recommendation 5) It is recommended that SeaBright complete schedule rating worksheets for all premium quotations and revisions. The Reason Bases and other rationale must be provided for the schedule credits/debits (additions & changes) and must be listed on the schedule rating worksheets and supported by file exhibits.

Recommendation 6) It is recommended that SeaBright implement & update policies, procedures, and training that will ensure that its application of the SRP does not exceed the limitations imposed by the State.

Recommendation 7) It is recommended that SeaBright apply its SRP in a consistent manner and only revise the resulting premium quotations when it becomes aware of actual changes in the circumstances upon which the original quotation was based. These changes must be documented (on the schedule rating worksheet), supported by valid exhibits, and must not be made for competitive reasons.

June 21, 2005

Linda S. Hall, CPCU, CIC
Director, Division of Insurance
Department of Community and Economic Development
550 West 7th Avenue, Suite 1560
Anchorage, AK, 99501-3567

Pursuant to Alaska Statute (AS) 21.06.120, the Alaska Division of Insurance performed a limited and targeted market conduct examination of the SeaBright Insurance Company (The Company) on March 7 through March 11, 2005, in the company's Anchorage Alaska Offices. The examination team consisted of Donald E. Hale, Examiner-in-Charge (EIC), Mr. Robert F. Sloper, Insurance Analyst, and Mr. Michael D. Ricker, Insurance Analyst, of the Alaska Division of Insurance.

SeaBright Insurance Company
(SeaBright)

SCOPE OF EXAMINATION

This examination was called to review The Company's application of its "Schedule Rating Plan" (SRP). This was a very limited and narrowly focused examination primarily involving those Procedure Steps directly related to the use of SRPs.

A note of explanation: the "targeted" nature of the examination speaks only to the fact that the subject matter being reviewed is "targeted". It does not imply the examinee was a "target". The term "targeted and limited" examination is utilized by the NAIC Market Conduct Examiners Handbook. "Target Examination", as defined by the handbook, reads as follows:

> "Target examinations are specific as to area of concern and may be called by any jurisdiction at any time with or without notice to the insurer as circumstance dictates.
>
> A target exam may involve the review of one or more business areas, where only selected standards may be reviewed." (NAIC Market Conduct Examiner's Handbook, 2004, U.S.A., Volume I, p.17.)

This is the first Market Conduct Examination of SeaBright, Conducted by the Alaska Division of Insurance.

P.O. Box 110805, Juneau, Alaska 99811-0805
Telephone: (907) 465-2515 Fax: (907) 465-3422 Text Telephone: (907) 465-5437
Email: insurance@commerce.state.ak.us Website: http://www.commerce.state.ak.us/insurance

Subject Matters Examined

The Alaska Workers' Compensation Market recently was dealt a severe blow, due in large part to the failure of California's Freemont Insurance Company. The resulting strain placed on the Alaska Guaranty Fund and Alaska Businesses has caused the Division of Insurance to intensify its regulatory oversight of the Alaska Workers' Compensation Insurance Market. SeaBright recently reported data to the Division of Insurance that raised concern about the company's schedule rating practices, in particular, the use of scheduled credits and/or debits applied during the rating process. The Company's Alaska writings increased significantly in 2004. Additionally a review of The Company's 4th quarter 2003 filing with The Division displayed a loss ratio of 392%. Therefore, The Division elected to review SeaBright's Underwriting and Rating practices, including the "bid files" to identify any potential problems that could be corrected early.

Time Frame

The examination review covered The Company's Underwriting and Rating Operations from October 1, 2003 through December 31, 2004.

COMPANY HISTORY & PRODUCTION PROFILE[1]

SeaBright

SeaBright Insurance Company (SeaBright) is primarily active in Alaska, California, and Hawaii, and its corporate offices are located in Seattle Washington. SeaBright is admitted in 47 states and only writes workers' compensation insurance.

SeaBright's origins began with the Eagle Pacific Insurance Company (EPIC). EPIC began writing specialty workers' compensation insurance almost 20 years ago, out of their Seattle Washington Office. In July of 1998, Lumbermens Mutual Casualty Company (Lumbermans), a Kemper company, acquired Eagle (EPIC) and Pacific Eagle Insurance Company (PEIC), known collectively at the time as Eagle Insurance Companies (EIC) and are the predecessors to SeaBright.

On January 1, 1999, EPIC and PEIC entered into quota share reinsurance arrangements with Lumbermens Mutual Casualty Company, their ultimate parent, whereby EPIC and PEIC ceded to LMC 80% of the net retained liabilities, after application of all external reinsurance, and 80% of underwriting expenses for all policies written by EPIC and PEIC from January 1, 1999 through December 31, 2002.

Due to subsequent financial difficulties encountered by Lumbermens and its pursuit of a solvent runoff plan, SeaBright Insurance Holdings, Inc., was formed in 2003 by members of the current management team (including prior EPIC Executives) and entities affiliated with Summit Partners, a private equity and venture capital firm. The reason for the formation of SeaBright Insurance Holdings was the completion of a management-led purchase of Kemper Employers Insurance Company (KEIC), a "shell company," from Lumbermens. The buyout closed on September 30, 2003, which The Company refers to as "The Acquisition." The Illinois Department of Insurance approved the name change to SeaBright Insurance Company on November 20, 2003. *EPIC was*

[1] Portions of this profile were taken from SeaBright's S1 Document (Prospectus dated 1/20/2005, prepared for the recent IPO) and www.sbic.com.

domiciled in Washington State and PEIC was domiciled in California. However, KEIC (subsequently SeaBright) was and SeaBright remains an Illinois Domestic Company.

In the Acquisition, The Company acquired the renewal rights and substantially all of the operating assets and employees of the former EPIC and PEIC, which The Company collectively refers to as Eagle or the Eagle entities. The Acquisition gave The Company renewal rights to an existing portfolio of business, representing a valuable asset given the renewal nature of The Company's business, and a fully-operational infrastructure. These renewal rights gave The Company access to Eagle's customer lists and the right to seek to renew Eagle's continuing in-force insurance contracts.

SeaBright's current chairman, chief executive officer and president joined EIC in December 1998, and other senior members of the current management team joined EIC in 1999. The combined ratio on the Eagle book of business has improved from 176% in 1999, the first year in which current management was responsible for the Eagle book of business, to 88% in pro forma 2003.[2] By comparison, the industry average combined ratio was 115% in 1999 and 108% in 2003. The Company believes the improvement in the combined ratio has resulted primarily from its focus on the niche markets in which The Company currently operates and its emphasis on larger accounts and fewer customers. For the four-year period beginning with 2000 through pro forma 2003, the gross premiums written on The Company's book of business increased at an average annual rate of 27%. For the nine months ended September 30, 2004, The Company had gross premiums written of $86.1 million, total revenues of $54.7 million and net income of $4.0 million. The Company's gross premiums written refer to its direct premiums written plus assumed premiums. Assumed premiums are premiums that The Company has received from another company under a reinsurance agreement or from an authorized state mandated pool.

The Company promotes itself as a specialty provider of multi-jurisdictional workers' compensation insurance. The Company focuses on employers with complex workers' compensation exposures, and provides coverage under multiple state and federal acts, applicable common law or negotiated agreements. The Company also provides traditional state act coverage in markets it believes to be underserved.

The Company currently provides workers' compensation insurance to customers in the following three targeted markets:

- **Maritime.** The Company focuses on employers with complex coverage needs over land, shore and navigable waters. This involves underwriting liability exposures subject to various state and federal statutes and applicable maritime common law. The Company's customers in this market are engaged primarily in ship building and repair, pier and marine construction and stevedoring. These customers generated $27.5 million, or 33.8%, of The Company's direct premiums written during the nine months ended September 30, 2004. Direct premiums written refer to all premiums billed by The Company during a specified policy period.

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2 Management has provided the Division the following information concerning this 2003 "pro-forma" combined ratio. "This number was developed by using Eagle Insurance Companies financial information for the first nine months of 2003, after which Eagle was placed in runoff. We included Eagle earned premiums, incurred losses and underwriting expenses for the three remaining months of 2003 while in runoff, and we also included SeaBright's actual financial results for the same period. So in brief, "pro-forma" was a way to examine an entire year's performance by combining the results of the predecessor companies with those of the new company."

- **Alternative Dispute Resolution.** The Company provides customized solutions to employers who are party to collectively bargained workers' compensation agreements that provide for settlement of claims out of court in a negotiated process. This product currently is focused on the needs of the construction industry in California. These customers generated $31.6 million, or 38.8%, of The Company's direct premiums written during the nine months ended September 30, 2004.

- **State Act.** The Company underwrites coverage for benefits that employers are obligated to pay specifically under state workers' compensation laws. The Company primarily targets states that it believes are underserved, such as California, Hawaii and Alaska. These customers generated $22.4 million, or 27.4%, of The Company's direct premiums written during the nine months ended September 30, 2004.

A part of The Company's operational plan is to maintain its experienced claims staff, during the transition. In order to accomplish this goal The Company continues to administer all of the Eagle runoff claims. The Company acts as a Third Party Administrator (TPA) for and receives fee income from Lumberman's Mutual for paying the run-off claims. Lumberman's Mutual is funding the claims from the reserves received from Eagle ($150,000,000). The Company's servicing of Eagle customers/claimants facilitated maintenance of its claims department. As the Eagle claims runoff diminishes, new SeaBright claims will take their place.

SeaBright's parent company, SeaBright Insurance Holdings, Inc., recently completed (January 2005) a successful Initial Public Offering (IPO). SeaBright Insurance Holdings sold eight million shares of common stock in exchange for $80.8 Million in proceeds. This capital infusion along with the floating of $12 Million in variable rate surplus notes (2004), and a Summit Partners infusion of $5.3 million (2004), is being used to bring SeaBright's surplus from ~$40 million in 2004 to ~$129.5 million, as of January 31, 2005.

SeaBright Insurance Company is a wholly owned subsidiary of SeaBright Insurance Holdings, Inc. SeaBright Insurance Holdings, Inc also owns PointSure Insurance Services, Inc., a Managing General Underwriter (MGU). Pointsure will be further discussed below.

SeaBright is authorized to issue Workers' Compensation Insurance in Alaska. Workers' Compensation Insurance is SeaBright's only line of business.

<u>SeaBright's 2004 Workers' Compensation Market Share</u>

Total Workers' Compensation Premium for Alaska in 2004 was $299,923,197.00. Of this amount, SeaBright underwrote $16,369,064.00 or 5.46%.

METHODOLOGY

The Market Conduct Section prepared and directed the call letter and all initial data requests to SeaBright's Seattle Home Office. A list of all Alaska business was requested, along with a list of all bid files (business not written) for the period to be reviewed. SeaBright complied with all data requests in a timely manner.

The following Procedure Steps (Standards & Tests) were followed and/or subject matter reviewed.[3]

1. The Company has an up-to-date, valid internal or external audit program.
    a. Determine how management is using the audit reports.
    b. Determine if the company responds to internal or external audit recommendations to correct, modify and implement procedures.
2. The Company has appropriate controls, safeguards, and procedures for protecting the integrity of computer information.
    a. Review computer security procedures.
    b. Review security procedures for electronic policy changes.
    c. Ensure there is adequate security of applicant/insured data secure during electronic transference of information.
3. The company adequately monitors the activities of the Managing General Agents (MGAs).
4. Records adequate, accessible, consistent, and orderly and comply with state record retention requirements.
    a. Review state record retention requirements to determine company compliance.
5. The company cooperates on a timely basis with the examiners performing the examination.
6. Verification of use of the filed expense multipliers; the company should be using a combination of loss costs and expense multipliers filed with the Department.
    a. Verify that the Loss Cost Multiplier (LCM) being used is the one filed and approved for use by the company.
    b. Verify that the schedule rating plan (SRP) being used is the one filed and approved for use by the company.
7. Credits and deviations are consistently applied on a non-discriminatory basis.
    a. Determine if the reasons for use of credits and debits are documented.
    b. Verify that the application of the schedule rating plan complies with limitations imposed by the state.
8. Schedule rating or individual risk premium modification plans, where permitted, are based on objective criteria with usage supported by appropriate documentation.
    a. Determine if the company is adjusting individual premiums to target premium levels for competitive reasons. Typically the test for this is to review the documentation in the underwriting files.
9. The company does not engage in collusive or anti-competitive underwriting practices.

3 *In light of the fact that this was a targeted examination with a narrow focus, Standards one through four above were reviewed and discussed with management, but not tested. Standards five through nine were specifically reviewed and examined for testing purposes.*

Acceptable Error Rate:
The Company's acceptable error rate for the above referenced standards and tests must be less than 10%.

Pre-examination Interview:

A pre-examination interview with SeaBright Senior Management was conducted by Mr. H. Theodore Lehrbach, Chief of Market Conduct, and Donald E. Hale, EIC on March 2, 2005, to obtain an overview of Company operations and management to discuss the purpose and scope of the examination. Seabright Senior Management Team Members present for the March 2, 2005 meeting were Joseph S. De Vita, Senior Vice President & CFO, Jeff Wanamaker, Vice President Underwriting, Richard Gergasko, Executive Vice President, James L. (Skip) Borland, III, Vice President, Chief Information Officer, and Keith Laughlin, Underwriting Director.

On Monday, March 7, 2005, the examiners arrived at The Company's Anchorage Office and were greeted by Mr. Tim Bryner, Regional Underwriting Manager. Mr. Bryner provided the examiners with complete access to the 72 SeaBright files to be reviewed. The review of all 72 files was completed by the end of business, Friday, March 11, 2005. The examiners were also given complete access to the "bid files" (business lost or not quoted) for review. Sixty-five of the bid files were reviewed during the visit.

The examiners provided Mr. Bryner with Exception Reports identifying issues that required additional information and/or clarification. Mr. Bryner forwarded these interrogatories to the Seattle office for reply. The Company was afforded the opportunity to agree with or dispute the findings contained in the Exception Reports. The last Exception Report (#3) was submitted on March 18, 2005. Mr. Wanamaker responded to all Exception Report interrogatories on behalf of the company. The collected data and completed Exception Reports support all statements made in this report.

On April 5, 2005, The Company provided the last requested documentation in the fieldwork process. Analysis of the data collected from the file review and subsequent correspondence warranted closure of the fieldwork phase of the examination on April 6, 2004.

THE SAMPLE

In light of the fact that The Company commenced operations on October 1, 2003, and by March 2005, had only 104 Alaska policy files; it was decided to forego a statistical sampling and examine all of the Anchorage office files. Based on the results of the Anchorage file review, a determination would be made concerning the possible examination of the Alaska files residing in The Company's Seattle home office. *It was determined that a review of the Seattle files is not required.*

A. COMPANY OPERATIONS AND MANAGEMENT

Comments: The evaluation of standards in this business area is based on review of Company responses to information requests, questions, interviews, and presentations made to the examiners. This portion of the examination is designed to provide a view of what the Company is and how it operates. It is not based on sampling techniques. It is more concerned with structure. This review is not intended to duplicate financial examination review but is important in establishing an understanding of the examinee. Many troubled companies have become so because management has not been structured to adequately recognize and address the problems that can arise.

The management of well-run companies generally has some processes that are similar in structure. While these processes vary in details and effectiveness from company to company, the absence of them or the ineffective application of them is often reflected in failure of the various standards that follow in this section and those following. The process usually includes:

- A planning function where direction, policy, objectives and goals is formulated;
- An execution or implementation of the planning function elements;
- A measurement function that considers the results of the planning and execution; and
- A reaction function that utilizes the results of measurement to take corrective action or to modify the process to develop more efficient and effective management of its operation.

Standard 1
The Company has an up-to-date, valid internal or external audit program.
AS 21.09.100

Comments: The review methodology for this standard is generic. A company that has no internal audit function lacks the ready means to detect structural problems until after problems have occurred. A valid internal or external audit function and its use is a key indicator of competency of management, which is an important factor the Director may consider in the review of an insurer. This standard was discussed with management, but not tested.

Result: Pass

Observations: As SeaBright is a publicly traded company, quarterly and annual audits are required. These audits are conducted by KPMG, LLP, an independent registered public accounting firm. In connection with KPMG's annual audit of the Company's consolidated financial statements, KPMG is required to have certain communications with the Audit Committee of the Company's Board of Directors. The Audit Committee comprises three independent, non-employee members of the Company's Board of Directors. The items required to be communicated to the Audit Committee include, but are not limited to, the following:

- Accounting policies and alternative treatments
- Quality of accounting principles
- Management judgments and accounting estimates
- Audit adjustments and uncorrected misstatements
- Disagreements with management
- Difficulties encountered in performing the audit
- Material written communications
- Significant deficiencies and material weaknesses

KPMG has similar communications with the Audit Committee in connection with its reviews of the Company's quarterly financial statements for the first, second and third quarters of the year. In addition to the Audit Committee meetings at which KPMG and management are both present, the

Audit Committee meets quarterly in separate executive sessions with KPMG and management.[4]

During our March 2, 2005 meeting with Senior Management, we mentioned to SeaBright that one of the triggers for this examination was the company's reported 392% Loss Ratio for the fourth quarter of 2003. In response, Management offered that they had just completed an actuarial review of their Alaska business, as they were also concerned about this loss ratio. Management explained that The Company commenced operations in the fourth quarter of 2003 (first policy dated 10/15/2003) and that they had a death claim almost immediately. This combined with a low level of new premium, at that time, resulted in the large loss ratio.

Price Waterhouse Coopers (PWC) prepares actuarial reviews for The Company on a quarterly basis, with particular attention paid to Reserves and Actuarial Calculations.

Standard 1
The Company has an up-to-date, valid internal or external audit program.

Topic 1) ***Determine how management is using the audit reports.***
Topic 2) ***Determine if accuracy of internal statistical data and information systems periodically tested by the company's audit program.***

AS 21.09.100

Comments: The review methodology for these topics is generic. These tests were discussed with management, but not tested.

Result: Pass

Observations: Senior Management states that they review the PWC reports, looking at them from an actuarial review and post the reserves acceptable to PWC's independent estimates. Currently, the Company has one year of claims information reflective of current operations.

Concerning the use of the KPMG quarterly and annual audits, Management and the Audit Committee meet regularly to review KPMG's conclusions and recommendations. By procedure, any comments regarding internal control deficiencies that may be made which have not already been corrected are discussed and, if necessary, promptly addressed.[5]

Standard 2
The company has appropriate controls, safeguards and procedures for protecting the integrity of computer information.

Topic 1) ***Review computer security procedures***
Topic 2) ***Review security procedures for electronic policy changes***
Topic 3) ***Is applicant/insured data secure during electronic transfer?***

- **AS 21.09.100**

Comments: Review methodology for this standard and tests is generic. Appropriate safeguards for protecting the integrity of the computer information are a public protection issue. Appropriate

[4] These comments were provided by SeaBright's Comptroller.
[5] This comment was provided by SeaBright's Comptroller.

controls, safeguards and procedures for protecting the integrity of computer files is an indicator of competency of management that the Director may consider in the review of an insurer. These items were discussed with management, but not tested.

Result: Pass

Observations: The Company has a complete Information Technology (IT) Department. All SeaBright data servers are in Seattle, and all customer/policy information resides there.

The Company uses Citrix Server Technology that allows all server infrastructure components and IT personnel to reside in the Seattle Home Office. This technology allows the branch office employees, using their work stations, to access and work with account records as though they were physically in the Seattle Home Office. Except for secure offsite back-up and disaster recovery purposes, the data never leaves the Seattle Servers. The branch office server infrastructure is only used to communicate with the Citrix Servers and manage the printing needs of the branch office employees. The Company provides further data security by using a private frame relay network, instead of using other comparable Internet Based Technology such as A Virtual Private Network or VPN. Branch office employees are provided high-speed Internet access for other business purposes, not involving policy records.

The Company maintains a hot site with a well regarded computer/data service company. This is used for disaster recovery purposes. The Company can designate any remote site as the back-up home office in the event of an emergency. Additionally, in recent disaster recovery tests The Company was able to retrieve all of the "mission critical" data in approximately 38 hours, well ahead of the industry norm of 72 hours.

Standard 5
The company adequately monitors the activities of the Managing General Agents (MGAs) (sic)
AS 21.27.590 – 21.27.620

Comments: Review methodology for this standard is generic. This standard has a direct insurance statutory requirement. This standard is focused on the level of the oversight provided by the Company when it contracts with an external entity that assumes a business function of the Company. The particular interest is on oversight impacting records and actions considered in a market conduct examination, such as but not limited to, trade practices, claim practices, policy selection and issuance, rating, complaint handling, etc.

Result: Pass

Observations: SeaBright does not use MGAs.

SeaBright Insurance Holdings, Inc. has a wholly owned Managing General Underwriter (MGU), Pointsure Insurance Services that operates on a wholesale basis. Pointsure holds an Alaska Adjustor & Producer Firm License and acts as a MGU. PointSure is licensed in 47 states and the District of Columbia.

Standard 7

Records are adequate, accessible, consistent, and orderly and comply with state record retention requirements.

AS 21.27.350, 3 AAC 29.400 (3)

Comments: Review methodology for this standard is generic. This standard has a direct insurance statutory requirement. This standard is intended to assure that an adequate and accessible record exists of the company's transactions. The focus is on the records and actions considered in a market conduct examination such as but not limited to, trade practices, claim practices, policy selection and issuance, rating, complaint handling, etc. Inadequate, disorderly, inconsistent, and inaccessible records can lead to inappropriate handling of claims, inappropriate rates and other issues which can provide harm to the public.

Result: Pass (Needs Improvement)

Observations: Alaska Regulation 3 AAC 26.030 requires that all files to be examined, contain all notes, papers documents, and similar material, and be in sufficient detail that those relevant events; the dates of those events, and all persons participating in those events can be identified.

The examiners generally found The Company's files legible and easy to understand. However, the examiners noted that the reason basis given for schedule debits and credits often remained the same from one year to the next, while those schedule debits and credits were changed at renewal. In most cases there were no other noted reasons in the file justifying those changes. 3 AAC 29.400 (3) requires that the documentation in an insurer's underwriting file provide sufficient detail to establish that the assignment of a credit or debit under a schedule rating plan complies with 3 AAC 29.400 -- 3 AAC 29.469. The examiners were informed that The Company creates a new file for each new policy period. The Company has stated that it does not maintain a (hard copy) "master file" containing the complete account history, due to size of its policy files. The Company further stated that it would not be practical to do so.

Recommendations:

Recommendation 1) It is recommended that SeaBright review, implement, and/or update policies, procedures and training to ensure that its files contain all notes, papers documents, and similar material, and be in sufficient detail that those relevant events; the dates of those events, and all persons participating in those events can be identified.

Standard 7
Records are adequate, accessible, consistent, and orderly and comply with state record retention requirements.

Test 1) ***Review state record retention requirements.***

- **AS 21.27.350, 3 AAC 21.470**

Comments: Review methodology for this test is specific. This test has a direct insurance statutory requirement. As the nature of the examinee's business may involve long term contingencies and liabilities, the focus is on the proper maintenance and availability of all historical records. This standard was discussed with management, but not tested.

Result: Pass

Observations: Per Senior Management, record retention for all files is to be 75 years for underwriting files. Claim file record retention surpasses Alaska State statutory requirements.

Standard 9
The company cooperates on a timely basis with examiners performing the examination.
AS 21.06.170, 21.06.120-21.06.160

Comment: Review methodology for this standard is generic. This standard has a direct insurance statutory requirement. This standard is aimed at assuring that the company is cooperating with the state in the completion of an open and cogent review of the company's operations in Alaska. Cooperation with examiners in the conduct of an examination is not only required by statute, it is conducive to completing the examination in a timely fashion and minimizing cost.

Result: Pass

Observations: During all phases of the examination The Company exhibited a positive and cooperative attitude. On several occasions, both Senior Management and Branch Office Personnel stated that they wished to use the examination process as learning experience and for improvement. Tim Bryner, Regional Underwriting Manager, in the Anchorage Branch Office was very cooperative with and responded timely to all examiner requests. It has also been a pleasure working with the Seattle Senior Management. All questions and request for information were responded to timely and in a professional manner.

B. UNDERWRITING AND RATING

Standard 1
Verification of use of the filed expense multipliers; the company should be using a combination of loss costs and expense multipliers filed with the Department.

Test 1) ***Verify that the company Loss Cost Multiplier (LCM) being used is the filed and approved LCM.***

- **AS 21.39.040(h)**

Comment: Review methodology for this standard and test is specific. This standard and test has a direct insurance statutory requirement. It is necessary to determine if the company is in compliance with rating systems, which have been filed with and approved by the Alaska Division of Insurance. Rates should not be unfairly discriminatory. Wide-scale application of incorrect rates by a company may raise financial solvency questions or be indicative of inadequate management oversight. Deviation from established rating plans may also indicate a company is engaged in unfair competitive practices.

Result: Pass (Needs Improvement, see recommendation)

Observations: SeaBright is using the old LCM previously approved for the Kemper Employer's Insurance Company (KEIC). This is more a matter of formality since SeaBright was formally KEIC, and has the same Company Code. However, numerous references were found in the files stating that certain rating decisions were made because of the "Inherent Inadequacy in the Alaska loss costs and in our LCM". *The use of this as a "Reason Basis" will be discussed elsewhere in the report.* Had The Company filed a new LCM it would have had the opportunity to review the adequacy of the current LCM, and could have filed for changes. Unfortunately this detail was most likely overlooked during the acquisition/transition as outlined in section one.

Recommendation 2) It is recommended that SeaBright re-file its Loss Cost Multiplier with the Division of Insurance and when doing so review its operational requirements for any changes that may be needed.

Standard 1
Verification of use of the filed expense multipliers; the company should be using a combination of loss costs and expense multipliers filed with the Department.

Test 2) ***Verify that the schedule rating plan (SRP) being used is the filed and approved schedule rating plan.***

- **AS 21.39.040(h)**

Comment: Review methodology for this test is specific. This test has a direct insurance statutory requirement.

Result: Pass (Needs Improvement, see recommendation)

Observations: SeaBright is using the SRP approved for the Kemper Employer's Insurance Company (KEIC). This is more a matter of formality due to the aforementioned reasons. However, the examiners found numerous "Reason Bases" that were not compliant with the approved SRP. *The use of these non-compliant "Reason Bases" will be discussed elsewhere in the report.* Had The Company filed a new SRP, the company would have had the opportunity to request changes that if approved, might have made some of the aforementioned "Reason Bases" compliant.

Recommendation 3) It is recommended that SeaBright file a new SRP with the Division of Insurance and when doing so review its underwriting/rating activities/needs for any changes that may be needed.

Standard 4
Determine if credits and deviations are applied consistently and on a non-discriminatory basis.
3AAC 29.420, 3AAC 29.425, AS 21.36.090, AS 21.36.120

Comment: Review methodology for this standard is specific. This standard has a direct insurance statutory requirement. Insurers must apply their filed schedules or rate credits and deviations on a non-discriminatory basis, consistency is the key in avoiding the appearance or actuality of an unfair discrimination.

Result: Fail

Observations: Of the 72 files reviewed, only nine had sufficient history to test for consistency. Of those nine files the examiners had concerns with seven. The examiners noted a consistent renewal rating practice where there is a reduction or increase to a schedule credit or debit versus the prior year, while providing the same Reason Basis given for the prior year. The underwriter gives the appearance that circumstances have changed, by adjustments to the schedule credits and/or debits at renewal. However the "Renewal Reason Basis" does not document any change in circumstances as a reason for the increase or reduction. Frequently the Reason Basis shown for the prior year and current year would appear to be positive statements that would either warrant no change or a positive change at renewal (reducing a debit or adding/increasing a credit).

Management responded by stating that "*In line with its policies and procedures to appropriately document files, SeaBright is revising the format of the schedule rating worksheet to expand space for an explanation of pricing changes from the previous year. SeaBright has initiated additional training to ensure full documentation regarding the change of schedule rating factors on renewals. After reviewing the referenced accounts, we can confirm that all of the changes noted were made with sound underwriting judgment, were based on factors within the file, and were not excessive, inadequate or unfairly discriminatory.*"

The "failure" of this test was not because the examiners found conclusive evidence that the debits and credits were being applied inconsistently, at renewal; but because the applicable files did not contain adequate documentation of the schedule rating plan worksheets. It should be noted that the examiners found no evidence of unfair discriminatory practices, despite this failure. While The Company has responded that sound underwriting judgment was used and based on factors within the file, the underwriter's reasoning or rational for the pricing changes were not evidenced in the file. In the absence of this information the examiners could not discern that these files were compliant in regard to this standard. The company has recognized that the schedule rating worksheet needs to be fully documented and has initiated measures to ensure that this will occur in the future.

Recommendation 4) Without proper documentation of the schedule rating work sheet, it is difficult for the company to demonstrate the consistent application of credits and debits. Therefore, it is recommended that SeaBrigtht implement policies and procedures that will ensure the proper documentation of all rating decisions made, including the application of schedule debits/credits and increases/decreases to schedule credits/debits. This documentation must include the underwriter's reasoning for the debits or credits applied and refer to supporting file documents.

Standard 4
Determine if credits and deviations are applied consistently and on a non-discriminatory basis.

Test 1) ***Determine if the reasons for use of credits and debits are documented.***

- **3AAC 29.420, 3AAC 29.425, AS 21.36.090, AS 21.36.120**

Comment: Review methodology for this test is specific. This test has a direct insurance statutory requirement. When underwriting is done with less than the required information, the likelihood of unfair discrimination increases.

Result: Fail (60 files passed and 12 failed for a 16.67% error rate. <10% error rate is acceptable)

Observations: As previously noted above, the Debits and Credits would change even when the Reason Basis, at renewal, did not change. The examiners recognize that there may be file documents supporting the underwriters reasoning for the modifications. However, the reasons for these modifications and deviations must be provided on the schedule rating worksheet. If the "Renewal Reason Basis" remains the same with no other clarification provided, then a change in the debit or credit would not appear to be warranted. Management has recognized the need to revise the schedule rating worksheet and procedures to provide an explanation for pricing changes from year to year.

Additionally, nine files contained multiple premium quotations, with supporting documentation (schedule rating worksheets) present only for the accepted final premium quotation. The examiners inquired with management concerning three of these files. The examiners asked if any of the alternate quotes were presented to the insured and at what point was schedule rating used to determine the final price? Management responded for all three files *"We do not know which proposals were presented to the insured."* Management's answers indicate that the broker may have been shown the alternate quotes. Therefore, it is reasonable to believe that the insureds were also shown some of the alternate quotes. Management did offer that once they became aware of other factors (through the brokers or finding prior items overlooked) they revised the quotes. Regardless of this information, a schedule rating worksheet should be present in the file for each premium quotation.

These questions also involved the test concerning competitive pressures. Management offered that these alternate quotes are not a result of competitive pressures. This test will be discussed later.

Recommendation 5) It is recommended that SeaBright complete schedule rating worksheets for all premium quotations and revisions. The Reason Bases & other rational must be provided for the schedule credits/debits (additions & changes), must be listed on the schedule Rating Worksheets and supported by file exhibits.

Standard 5
Schedule rating or individual risk premium modification plans, where permitted, are based on objective criteria with usage supported by appropriate documentation.

Test 1) ***Verify that the application of the schedule rating plan complies with limitations imposed by the state.***

- **3AAC 29.415, 3AAC 29.420, 3AAC 29.435, AS 21.36.090, AS 26.36.120, AS 21.39.040 (h)**

Comment: Review methodology for this standard and test is specific. This standard and test has a direct insurance statutory requirement.

Result: Pass, Needs Improvement (67 files passed & 5 failed, Error Rate 7.46%)

Observations: The examiners found four files containing schedule rating plan worksheets with an inappropriate debit for the classification category. The Reason Basis stated is "Modified Manual Premium below $75,000 NW (Northwest) Minimum Premium Guideline." This is not a valid reason basis for the debits applied in these files, as it is not a part of the filed and approved SRP. In other words, the use of this reason for the deviations is not within the descriptions of characteristics as outlined on the state approved form (classification peculiarities, safety devices, safety management).

__A Note Concerning The Bid Files__: During the time permitted, the examiners were able to review 65 bid files (business not written, but quoted). When reviewing the bid files the examiners found evidence of the improper use of an un-filed rating plan. On numerous occasions The Company declined to quote on business submitted to it. The Company declined to bid on 54 (83%) of the 65 files. Of the 54 files declined 19 (35%) were declined primarily because they did not meet The Company's optimal premium guideline of $75,000.00. While declining to bid on risks that generate a premium less than a minimum targeted is not statutorily prohibited, the examiners found (as previously noted) that The Company applied a five percent debit to four premium quotations because the Standard Premium was less than $75,000.00 minimum premium guideline. This rating methodology was not part of any approved rate filing for The Company.

Management was asked why it believes this practice is in compliance with the approved schedule Rating Plan (SRP). Management responded, *"we agree that the schedule credits and debits should only be those in the schedule rating plan as filed and approved by the AK Department of Insurance. Further, we agree that SeaBright's internal minimum premium guideline is not an approved justification for the use of schedule rating. The Company has reviewed this and initiated training to ensure compliance with schedule rating requirements. The company will not use this reason on future policies."*

For two other files in question, the examiners were concerned that the same Reason Basis was used twice under two separate categories, allowing the company to obtain debits in excess of the maximum allowed for the Reason Basis. Management responded for both files, *"We are unable to find in the filing, or in the Alaska statutes a section that prohibits a company from using the same reason in multiple categories, if they apply. The documented reason under "Classification Peculiarities-Rate" appears to be incomplete. The underwriter should have clarified his judgment by documenting his complete thought process in the file."* On further review, we agree that the characteristics and descriptions approved may be sufficiently vague to allow a single reason to be used for debits or credits under multiple risk characteristics.

It was also noted in one file that the *"inherent inadequacy in Alaska Loss Costs and in our LCM"* was improperly used as a Reason Basis to justify a debit on one SRP Worksheet. Although this is the only instance where this reason was specifically used in the premium calculation, the examiners noted that the underwriter's perception of the Loss Cost Multiplier (LCM) was often referred to in the file notes and correspondence as justification to brokers and others for the addition of schedule Debits. Management responded, *"We agree that the company must adhere to the filed schedule rating plan. At the time these policies were underwritten, we had a perception that overall Alaska Loss Costs and subsequent rates were inadequate in Alaska. The NCCI filed, and the Department of Insurance eventually approved, double digit loss cost increases two years in a row -essentially substantiating our perceptions. Since underlying costs of losses were increasing, we did feel we needed commensurate premium increases, overall. However, our pricing on an individual account is not based on rate adequacy, nor is it the rationale used to justify the schedule rating applied.* Management further responded, *"While we often discuss the overall rate adequacy, both verbally and within emails, our underwriting procedures and practices do not support using rate adequacy or loss cost multiplier levels as a reason for adjusting schedule rating.*

Regardless of Management comments, the documentation supports that The Company did use the LCM on one occasion as a Reason Basis. This combined with the numerous comments concerning the *"inherent inadequacy in Alaska Loss Costs and in our LCM"* might explain an imbalance of debits to credits found in the files. The examiners observed 611 total debits versus 264 total credits, representing a **2.31:1 ratio**. This comment is being made in light of the fact that the files often contained both negative and positive risk data. In many cases the negative information was used to justify debits, while the positive information did not appear to be seriously considered for credits.

Recommendation 6) It is recommended that SeaBright implement & update policies, procedures, and training that will ensure that its application of the SRP does not exceed the limitations imposed by the State.

Standard 5
Schedule rating or individual risk premium modification plans, where permitted, are based on objective criteria with usage supported by appropriate documentation.

Test 2) ***Verify that changes in the amounts of credit or debit are supported by documentation or an explanation that is consistent with the change. Also that the basis for use is appropriate (i.e., based on objective criteria not on perceived competitive pressures.)***
3 AAC 29.420, 3 AAC 29.425, AS 21.36.090, AS 26.36.120, AS 21.39.040 (h)

Comment: Review methodology for this test is specific. This test has a direct insurance statutory requirement.

Result: Pass, Needs Improvement (67 files passed & 5 failed, Error Rate 6.94%)

Observations: There were a total of nine files the examiners inquired about for this test. All of these files had changes to their scheduled credits and debits that did not appear to be supported by the documentation or the explanation did not seem to be consistent with the change.

For four of the files Management responded *"We agree that SeaBright should document reasons for schedule rating changes from one year to the next and the companies schedule rating plan provides space for such documentation. The schedule rating worksheets on the four accounts noted were inaccurately completed. SeaBright (KEIC) was not the previous carrier, therefore the previous pricing column of the schedule rating plan should not have been completed by the underwriter. The prior carrier was Eagle Pacific Insurance Company."*

Two files had schedule rating applied to reflect or offset changes in the experience modification factor. One of the files in question, had its total debits increased from 15% to 25% prior to policy issuance. When this file was initially rated, the experience modification provided was .95 and the premium calculated included a 15% debit. Upon receipt of an updated experience modification factor (.86) the premium was recalculated and it included a 25% Debit. A change in the experience modification is not a valid reason to adjust the schedule rating on an account.

Management responded, *"The experience modification is the primary factor that reflects the experience of the risk. Schedule rating, based on sound underwriting judgment, is used to adjust the* *premium to consider qualities of the account that the experience modification does not contemplate. The experience modification is the primary factor that reflects the experience of the risk. Schedule rating, based on sound underwriting judgment, is used to adjust the premium to consider qualities of the account that the experience modification does not contemplate."*

The examiners disagree with Management's reasoning. Experience rating contemplates past accident frequency and severity and the schedule rating plan contemplates workplace characteristics that cannot be objectively quantified. The rating factors involved in these two different modifications should be mutually exclusive. Furthermore, by 3 AAC 29.420, the use of schedule rating in such a way as to duplicate other rating or rate development factors is prohibited, so in fact, the rating factors contemplated in experience modification and schedule rating must be mutually exclusive.

Additionally, the rating factors contemplated in the experience rating do not vary from one application of the modification to the next, and likewise the rating factors contemplated in the schedule rating do not vary from one application of the plan to the next. Therefore, just as the previous experience modifier did not contemplate characteristics that were also considered in the application of schedule rating (assumed true by 3 AAC 29.420), the new experience modifier will not contemplate characteristics that were previously considered or should simultaneously be considered in the application of schedule rating.

For the three remaining files The Company provided appropriate Reason Bases for the use of the schedule rating applied. However, because *"the underwriter completed his renewal evaluation without completely documenting the schedule rating worksheet"* these files must fail this test.

Recommendation) (See Recommendation 6)

Standard 5
Schedule rating or individual risk premium modification plans, where permitted, are based on objective criteria with usage supported by appropriate documentation.

Test 3) ***Determine if the company is adjusting individual premiums to target premium levels for competitive reasons.***

- **AS 21.36.090, AS 21.39.040(h)**

Comment: Review methodology for this test is specific. This test has a direct insurance statutory requirement.

Result: Pass, Needs Improvement (67 files passed & 5 failed, Error Rate 6.94%)

Observations: As previously noted, there were nine files that contained multiple premium quotations, with supporting documentation (properly documented schedule rating worksheet) present only for the accepted premium quotation. Of these nine files, five had corroborating documentation supporting the conclusion that their premium quotations were adjusted for competitive reasons and thus they failed this test.

The five files that failed contained alternate premium quotations revealing a progression of schedule debit reductions at each rate revision, prior to acceptance of the final bid by the insured.

Furthermore, these files contained email and other correspondence clearly indicating these rate revisions were made for competitive reasons. As previously noted, Management's answers have indicated that the brokers and/or insureds may have seen the alternate quotes in question.

- One file contained a series of email messages, where the broker asked the underwriter to reduce the schedule debits from 25% to 20%. It appears that this request was made in response to competing bids. The underwriter agreed to reduce the debits to 20% if the broker would reduce his commission from 10% to 7.5%. This was done and had the effect of splitting the 5% debit reduction with the broker.
- The Underwriting Documentation Log in another file contained information where the broker advised SeaBright of the premium reduction needed to renew the account. The premium was reduced and the company kept the business.
- In one file the underwriter, in response to broker pressure, asked how much more the debits needed to be reduced. The debits were reduced and the company wrote the business.
- On another occasion the broker stated that the client was dismayed about their experience with The Company quoting an initial price and then reducing it in response to competitive bids.
- Management responded, *"Premiums were not adjusted for competitive reasons, but to appropriately price these risks based on their unique risk characteristics. In the normal course of business, underwriters may become aware of, and comment on, the competitiveness of the marketplace, but we do not price the business based on the competition's pricing. Understanding the customers' expectation of premium levels helps us screen applications, so we are able to efficiently employ our limited resources on prospects we are more likely to obtain as insureds."*
- The examiners reviewed these files again and concluded again that the multiple quotations combined with the file correspondence supports that The Company did adjust these premium quotations to target premium levels for competitive reasons. These four files were failed.

Additionally, there was at least one time where a total net credit was applied when the underwriter had knowledge that certain competitors were bidding. On this occasion, the underwriter provided a quotation with a 20% credit prior to receipt of the loss control survey, after receiving information that two particular competitors were quoting on the risk in question.

- Management responded, *"In this case, the underwriter commented on competitor's suspected use of schedule credits, but did not know the competition's pricing until after he released the proposal. The underwriter did not price the account based on the competition's price."*
- The examiners disagree. After the business was placed the underwriter said that both competitors quoted with 20% schedule credits. He noted that this was not enough because of The Company's 20% schedule credit, combined with its lower LCM. This is not convincing in and of itself.
- However, in another file from the prior year, the underwriter provides documentation that one of the same competitors would need to quote with a total schedule credit of 20% to beat his bid.
- In light of the prior file notation and the fact that the underwriter quoted a total net 20% credit before receipt of the loss control survey, combined with the company's apparent bias

toward schedule debits, it is reasonable to believe that the underwriter had advance competitive information and priced this risk to target premium levels for competitive reasons and this file was failed.

Recommendation 7) It is recommended that SeaBright apply its schedule rating plan in a consistent manner and only revise the resulting premium quotations when it becomes aware of actual changes in the circumstances upon which the original quotation was based. These changes must be documented (on the schedule rating worksheet), supported by valid exhibits, and must not be made for competitive reasons.

Standard 11 The Company does not engage in collusive or anti-competitive underwriting practices.
Test 1) ***Review interoffice memoranda for evidence of anti-competitive behavior.***   • **AS 21.36.090, AS 21.36.120**

Comment: Review methodology for this standard and test is specific. This standard and test has a direct insurance statutory requirement. This standard and test is intended to assure that any practice suggesting anti-competitive behavior is not tolerated. This includes engaging in collusive underwriting practices that may inhibit competition, e.g., entering into an agreement with other companies to divide the automobile market within Alaska by territory.

Result: Pass

Observations: The examiners found no evidence that the company engages in anti-competitive behavior.

SUMMARY AND SUBSEQUENT EVENTS

Summary

This was a very narrowly focused examination of SeaBright's use of schedule credits and debits when underwriting and rating Workers Compensation risks. The Division chose eight Underwriting and Rating Procedures Steps (Standards & Tests, taken from the NAIC Market Conduct Examiner's Handbook) pertaining to and focusing on The Company's implementation of the filed and approved schedule rating plan (SRP). The Procedure Steps under Operations/Management were completed to help develop a general overview of the company's history and operation.

It should be noted that other items (in addition to schedule credits/debits) not reviewed in this examination could also have an impact on the final Workers' Compensation Rates quoted by an insurance company. In one instance the examiners noted that SeaBright disagreed with a competitor on the classification of "Cleaners." The competitor had classified the cleaners as carpenters. The competitor's bid was substantially higher than SeaBright's bid because of this classification difference.

SeaBright Management has demonstrated a desire to run the company in a prudent manner. The Company is diligent in its efforts to protect & safeguard customer records and its own operations in the face of a potential disaster. The Company has invested substantial resources toward this aim. Management closely monitors The Company's performance via external audits, reviewing them from an actuarial perspective. After a review of the audits, Management has stated that it posts the reserves based on the audit results at a level acceptable to PWC estimates, as the Company has one year of claims information reflective of current operations. Additionally, during the examination the examiners noted The Company's strong desire to adequately price the business it was bidding on.

Management and company staff were very cooperative during all phases of the examination. Management and staff stated on more than one occasion, a desire to learn from the examination and use it to improve company operations. The examiners appreciated this attitude and enjoyed working with SeaBright Management and Staff.

Several significant issues did arise during the examination.

While it appeared that the Regional Underwriting Manager in Anchorage was diligent in his efforts to develop an adequate premium (more often applying debits instead of credits when he felt the Standard Premium was inadequate), the examiners found substantial evidence constituting an improper use of the filed rating plan. Frequently, the Reason Bases given were not in accordance with the categories in the approved SRP. Additionally, Reason Bases were found that were not approved for use under the SRP. Management has addressed this concern, by implementing corrective changes.

Incomplete documentation was also often a problem. The Worksheets often lacked adequate detail to explain the variability of credits and debits at policy renewal. Management acknowledged that its implementation of the approved SRP required modification to improve and maintain compliance with the requirements and limitations imposed by the state. Accordingly, Management has implemented corrective changes.

Apparently (during the period reviewed) The Company felt (and the documentation confirms) that the Alaska Loss Cost and The Company's Loss Cost Multiplier were inadequate. This is further borne out by a statistical analysis of the files examined, revealing a heavy bias toward the application of schedule debits versus schedule credits. During the examination Management did state that it no longer held this opinion, due to adequate rate increases filed by the NCCI and approved by the Alaska Division of Insurance. Regardless of the current opinion, the examiner's noted that the SRP and the Loss Cost Multiplier in use by SeaBright are those filed by and approved for use by the Kemper Employers Insurance Company (KEIC). Again, this is more a matter of formality since SeaBright was KEIC, and has the same Company Code as KEIC. However, many of the problems found <u>might</u> have been avoided had The Company opted to review its needs and had then submitted a new SRP and Loss Cost Multiplier to the state.

Re-Examination

In closing, while the examiners found problems with SeaBright's application of the approved SRP, they also found that the company generally attempts to price its book of business in a prudent manner. While there was some evidence that on occasion, The Company yielded to competitive pressures, the overall bias was toward the application of schedule debits versus schedule credits. It was noted that the Underwriter was consistently concerned that the proper pricing of his premium recommended actions, including those already taken by The Company, should correct the problems encountered and it is recommended that SeaBright be reexamined within the next two years to ascertain compliance with them.

Submitted by:

Donald E. Hale, CLU
Examiner-in-Charge

REPORT ON MARKET CONDUCT EXAMINATION CERTIFICATION

State of Alaska)
) ss.
Third Judicial District)

Donald E. Hale, being duly sworn, deposes and says that the foregoing report submitted by him is true to the best of his knowledge and belief.

Donald E. Hale, CLU
Examiner-in-Charge

SUBSCRIBED and SWORN to before me this 21st day of June, 2005

"OFFICIAL SEAL"
CATHERINE A. WATSON
NOTARY PUBLIC, STATE OF ALASKA
MY COMMISSION EXPIRES 1/24/2009

Notary Public in and for Alaska
My Commission Expires 1/24/2009

SeaBRIGHT
INSURANCE COMPANY

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JUL 27 2005
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DIVISION OF INSURANCE
JUNEAU OFFICE

July 21, 2005

Ms. Linda Hall, Director of Insurance
c/o H Theodore Lehrbach, Chief Examiner Market Conduct
Department of Commerce & Economic Development
Alaska Division of Insurance
PO Box 110805
Juneau, AK 99811-0805

Re: Response to Limited Market Conduct Examination
SeaBright Insurance Company
Division of Insurance File Number: MCE 05-01

Dear Director Hall;

Thank you for the opportunity to provide your office with our response to the final report for the above examination. We ask that you include this response as a separate document to the final report wherever the report is published.

We would like to advise you of a point of clarification to the Company History and Profile section of the report. The "Company" is defined in the Report as SeaBright Insurance Company and on page 6, paragraph 4, the Report states that "The Company recently completed (January 2005) a successful Initial Public Offering (IPO)." In fact, it is SeaBright Insurance Holdings, Inc., SeaBright Insurance Company's parent company, that successfully went public in January 2005.

Please find below the examiners recommendations recited, followed by SeaBright Insurance Company's response:

Recommendation 1: It is recommended that SeaBright review, implement, and/or update policies, procedures and training to ensure that its files contain all notes, papers documents, and similar material, and be in sufficient detail that those relevant events; the dates of those events, and all persons participating in those events can be identified.

> **Company Response:** *SeaBright has reemphasized through additional training the importance of file documentation, specifically the requirement that schedule rating credits or debits must be supported with file documents located in the current policy year's file, not files from previous policy years.*
>
> *Underwriters have been advised that appropriate documentation must be in sufficient detail to support the underwriters reasoning in the application of schedule credits or debits.*

2101 4th Avenue, Suite 1600, Seattle, WA 98121
Mailing Address: P.O. Box 91100, Seattle, WA 98111
Phone: 206 269 8500 Fax: 206 269 8903
Website: www.sbic.com

Recommendation 2: It is recommended that SeaBright re-file its Loss Cost Multiplier (LCM) with the Division of Insurance and when doing so review its operational requirements for any changes that may be needed.

> **Company Response:** *SeaBright filed a revised loss cost multiplier (LCM) on April 25, 2005 to be effective 8-1-2005. On May 9, 2005 the Division responded with questions and additional informational needs. SeaBright responded to those questions on June 16, 2005.*
>
> *SeaBright reviewed and made changes to other rating and non-rating plans, including the Premium Payment Plan, the Alaska Schedule Rating Plan and the Workplace Safety Program in conjunction with the LCM filing. Approval of this filing is currently pending with the Division of Insurance.*
>
> *SeaBright filed separately, an updated Alaska Installment Payment Plan Form which was approved by the division June 2, 2005.*

Recommendation 3: It is recommended that SeaBright file a new "Schedule Rating Plan" (SRP) with the Division of Insurance and when doing so review its underwriting/rating activities/needs for any changes that The Company would like to submit for regulatory approval.

> **Company Response:** *As part of the Loss Cost Multiplier filing referred to above, SeaBright made changes to, and filed with the Division, a new schedule rating plan. SeaBright has reviewed its underwriting/rating activities and incorporated those in the filing. Approval of the filing is pending with the Division of Insurance.*

Recommendation 4: Without proper documentation of the "Schedule Rating Worksheet," it is difficult for the company to demonstrate the consistent application of credits and debits. Therefore, it is recommended that SeaBright implement policies and procedure that will ensure the proper documentation of all rating decisions made, including the application of schedule debits/credits and increases/decreases to schedule credits/debits. This documentation must include the underwriter's reasoning for the debits or credits applied and refer to supporting file documents.

> **Company Response**: *SeaBright does not engage in unfair discrimination and concurs with the examiners' acknowledgment that the Company's underwriting files do not indicate that practice. It is SeaBright's policy and procedure to thoroughly document rating decisions. SeaBright provided immediate refresher training to the underwriters directly affected by this examination regarding Schedule Rating Plan documentation, supporting file documents and the application of credits and debits. Additional training for all company underwriters has been initiated regarding the use of schedule rating.*
>
> *As a result of this examination, SeaBright has re-designed the schedule rating plan form, to correspond with the revised schedule rating plan that was filed with the Division on April 25, 2005. This new form, when implemented following Division approval, will be used by the underwriters to clearly document the basis for credits or debits, including reasons for changes from prior years. The revised form is designed to improve consistency and documentation as recommended by the examiners.*
>
> *Additionally, the scope of SeaBright's internal underwriting audit process has been expanded. Future underwriting audits will specifically audit the use of schedule rating, proper documentation and supporting file exhibits. Files will be audited for evidence that the underwriting reasoning for applying debits or credits is appropriately reflected.*

Recommendation 5: It is recommended that SeaBright complete schedule rating worksheets for all premium quotations and revision. The Reason Basis and other rationale must be provided for the schedule credits/debits (additions & changes) and must be listed on the schedule rating worksheets and supported by file exhibits.

> **Company Response:** *SeaBright has revised its underwriting procedure to address this recommendation. Specifically, it is the company's revised procedure that: 1) the schedule rating worksheet must be completed by the underwriter for all versions of quotes released to the broker, and 2) the underwriting file must contain all documentation to support revisions of schedule credits or debits.*

Recommendation 6: It is recommended that SeaBright implement & update policies, procedures and training that will ensure that its application of the SRP does not exceed the limitations imposed by the State.

> **Company Response:** *It is SeaBright's policy and procedure to thoroughly document rating decisions. SeaBright has re-designed the schedule rating plan form used in the underwriting file to clearly document the basis for any credits or debits, including reasons for changes from prior years. The revised form is designed to improve consistency and to complete the documentation as recommended by the examiners.*
>
> *SeaBright provided immediate refresher training to the underwriters directly affected by this examination regarding Schedule Rating Plan documentation, supporting file documents and the application of credits and debits. Additional training for all company underwriters has been initiated regarding the proper use of schedule rating.*
>
> *Further, the scope of SeaBright's internal underwriting audit process has been expanded. Future underwriting audits will specifically audit the use of schedule rating, proper documentation and supporting file exhibits. Files will be audited for evidence that the underwriting reasoning for applying debits or credits is appropriately reflected.*

Recommendation 7: It is recommended that SeaBright apply its SRP in a consistent manner and only revise the resulting premium quotations when it becomes aware of actual changes in circumstances upon which the original quotation was based. These changes must be documented (on the schedule rating worksheet), supported by valid exhibits, and must not be made for competitive reasons.

> **Company Response:** *It is SeaBright's policy and procedure to thoroughly document rating decisions. SeaBright has re-designed the schedule rating plan form used in the underwriting file to clearly document the basis for any credits or debits, including reasons for changes from prior years. The revised form is designed to improve consistency and to complete the documentation as recommended by the examiners.*
>
> *SeaBright provided immediate refresher training to the underwriters directly affected by this examination regarding Schedule Rating Plan documentation, supporting file documents and the application of credits and debits. Additional training for all company underwriters has been initiated regarding the proper use of schedule rating.*
>
> *Additionally, the scope of SeaBright's internal underwriting audit process has been expanded. Future underwriting audits will specifically audit the use of schedule rating, proper documentation and supporting file exhibits. Files will be audited for evidence that the underwriting reasoning for applying debits or credits is appropriately reflected.*

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JUNEAU OFFICE

In closing, SeaBright Insurance Company strives to comply with all applicable statutes and regulations with regard to its business operations. We continue to review and improve procedures and remain strongly committed to compliance. We also wish to thank your staff for their work and professionalism throughout the examination

Sincerely,

Jeff Wanamaker

Jeff Wanamaker, CPCU, ARe
Vice President – Underwriting
SeaBright Insurance Company

CC: Don Hale, Insurance Analyst

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