

MARKET CONDUCT REPORT

ON

NATIONAL INTERSTATE
INSURANCE COMPANY

AS OF

September 30, 2008

I, Karen Weldin Stewart, CIR-ML, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON MARKET CONDUCT EXAMINATION, made as of September 30, 2008 of the

NATIONAL INTERSTATE INSURANCE COMPANY

is a true and correct copy of the document filed with this Department.



ATTEST BY: _____

DATE: March 9, 2010



In Witness Whereof, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 9TH DAY OF MARCH 2010.



Karen Weldin Stewart, CIR-ML
Insurance Commissioner

REPORT ON MARKET CONDUCT EXAMINATION
OF THE
NATIONAL INTERSTATE INSURANCE COMPANY
AS OF
SEPTEMBER 30, 2008

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.



In Witness Whereof, I HAVE HEREUNTO SET MY HAND
AND AFFIXED THE OFFICIAL SEAL OF THIS
DEPARTMENT AT THE CITY OF DOVER, THIS 9TH DAY
OF MARCH 2010.

A handwritten signature in black ink, appearing to read "Karen Weldin Stewart", is written over a horizontal line.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

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SALUTATION

January 12, 2009

Honorable Karen Weldin Stewart
Insurance Commissioner
State of Delaware
841 Silver Lake Boulevard
Dover, Delaware 19904

Dear Commissioner :

In compliance with the instructions contained in the Certificate of Examination Authority Number 08-724 and pursuant to statutory provisions including 18 Del. C. §318-322, a Targeted Market Conduct Examination has been conducted of the affairs and practices of:

National Interstate Insurance Company.

National Interstate Insurance Company, hereinafter referred to as the "Company," or as "NIIC," is incorporated under the laws of the State of Ohio. This examination consists of two phases, an on-site phase and an off-site phase. The on-site phase of the examination was conducted at the following Company location:

3250 Interstate Drive, Richfield, Ohio 44286

The off-site examination phase was performed at the offices of the Delaware Department of Insurance, hereinafter referred to as the "Department" or "DDOI," and other appropriate locations.

The report of examination thereon is respectfully submitted.

FOREWORD

This examination reflects National Interstate Insurance Company's insurance activities in the State of Delaware. This Market Conduct Examination Report is, in general, a report by exception. As such, some of the information reviewed by the examiners will not be referenced in this written report, since reference to or comments about any practices, procedures, or files that did not result in any errors or irregularities is generally not made.

In performing this examination the DDOI selected a portion of the Company's operations for review. This report does not fully reflect a review of all of the practices and activities of the Company.

Where used in the report:

“Company” or “NIIC” refers to National Interstate Insurance Company

“Del. C.” refers to the Statutes of Delaware

“DE Admin. Code” refers to Delaware's Regulations

“DDOI” refers to the Delaware Department of Insurance

“NAIC” refers to the National Association of Insurance Commissioners

“NAIC MCEH” refers to the NAIC's *Market Conduct Examiners' Handbook*

SCOPE OF EXAMINATION

The Delaware Department of Insurance has authority to perform this examination pursuant to, but not limited to, 18 Del. C. §§318-322. This target examination of National Interstate Insurance Company began November 9, 2008 and covered the period of January 1, 2006 through September 30, 2008, unless otherwise noted. This target examination focused on a review of the Company's underwriting and rating practices for its Personal and Commercial Lines, and included a review of the Company's Complaint Handling.

This examination was performed in accordance with Market Regulation standards established by the Department and examination procedures established by the NAIC. While the examiners report on the errors found in individual files, the examination also reviewed general business practices of the Company.

It is the Department's practice to cite companies for errors or apparent violation of a statute or regulation when the results of a census review or sample review shows errors/noncompliance at or above the following levels: 0 percent (0%) for Complaints, Sales and Advertising, producers who are not appointed and/or licensed, and the use of forms, rates and rules that are neither filed with nor approved by the Department; seven percent (7%) for claims; and ten percent (10%) for all other areas reviewed. Any operation with an error ratio in excess of these criteria indicates a general business practice.

When errors are detected in a sample yet the error rate is below the applicable threshold for citing an apparent violation, the Department may choose to issue a Management Letter to the company.

EXECUTIVE SUMMARY

This Market Conduct Examination focused on the rating and underwriting practices of National Interstate for Recreational vehicles and Commercial vehicles

The Company provides insurance for individuals and business entities. The Company issues its policies through Independent agents, agencies and one Managing General Agency, Hudson Management Group, Ltd (HMG).

The examiners noted deficiencies in the Company's procedures and practices in the areas of Commercial Underwriting. The details of these findings are provided in the respective section of the report. In summary, the examiners noted the following:

- Underwriting – Commercial Lines - the Company did not follow the rates filed with the DDOI which resulted in incorrectly rated Commercial Automobile policies. The Company also failed to file its rental car coverage plan which resulted in the Company using rates not filed with the DDOI.

For the cited exceptions in the report, Recommendations have been made to address the issues and concerns noted by the examiners.

EXPLANATION OF THE EXAMINATION PROCESS

FORMS, FILINGS AND UNDERWRITING GUIDELINES

The examiners review the Company's policy forms and underwriting guidelines to determine compliance with filing approval and content requirements, to ensure that the contract language is not ambiguous, and that the provisions of the policies adequately protect the insureds. In addition, the examiners review the Company's underwriting guidelines and compare them with the active files and terminated files in order to determine if the Company is adhering to its own guidelines.

AUTHORITY

Delaware law limits which companies may sell insurance, as well as the type of insurance that a company is allowed to market. The Department issues a Certificate of Authority to an insurer only after the insurer has completed an application process. The examiners review the Company's operations to ensure they are in compliance with their Certificate of Authority and the licensing requirements of Delaware.

COMPLAINTS

The examiners review the complaints the Company received directly from consumers, the complaints submitted by the Department and the complaints received by the Department. The purpose of the review is to determine the accuracy of handling and the resolution of the complaint along with the timeliness of the response.

UNDERWRITING AND RATING

The examiners review the Company's underwriting and rating practices, which includes the use of policy forms, adherence to underwriting guidelines and company manuals, assessment of premium and declination and termination procedures.

SAMPLING OF FILES

The examiners did not conduct a sample review of the files since this examination was a targeted examination and the field sizes were small enough that a census review could be performed.

The most useful measurement of the Company's compliance with the law is the percent of files in error. The types of practices considered to be in error include, but are not limited to: miscalculation of premium based upon the information in the file; improper acceptance or denial of an application; unreasonable delay in the acknowledgement, investigation, payment or denial of a claim; failure to correctly calculate claim benefits and failure of the Company to comply with Delaware's laws and regulations.

Some files may contain multiple errors which are indicated by category but only considered once when determining the error ratio. The error ratio criterion used to develop confidence levels for the policy files review is ten percent (10%) and for the claim files review it is seven percent (7%), as established by the NAIC and adopted by the Delaware Department.

EXAMINATION FINDINGS

I. Company Overview

A. History

National Interstate Insurance Company was incorporated in Ohio on February 23, 1989. The Company is wholly-owned by National Interstate Corporation, a publicly traded company. (NASDAQ: NATL). National Interstate Corporation is a majority owned property-casualty subsidiary of Treat American Insurance Company, a wholly-owned subsidiary of American Financial Group, Inc. (NASDAQ: AFG), (NYSE: AFG). The Company is rated "A" (excellent) by A.M. Best Company.

From inception until December 31, 2006, the Company's President was its founder, Alan R. Spachman. Effective January 1, 2007 Mr. Spachman began serving as Chairman of the Board of the Company and continues to hold that position. Effective January 1, 2007, David W.

Michelson, the Company's former Chief Operating Officer, became President and Chief Executive Officer.

The Company is a product management organization. Each of their product lines is headed by a manager solely responsible for achieving that product line's planned results. The Company believes that the use of a product management organization provides the focus required to successfully offer and manage its diverse set of product lines.

B. Profile

The Company is licensed in all fifty (50) states and the District of Columbia. The Company primarily writes commercial and personal lines property and casualty insurance coverage with a focus on providing liability insurance to transportation businesses, including passenger transportation companies (such as buses, taxis, para-transit operators), trucking companies and owners of recreational vehicles.

C. MGA and Vendor Oversight

The Company identified Hudson Management Group, Ltd (HMG), United States Virgin Islands, as an insurance services company performing business functions during the examination period.

The review of HMG's contract shows the duties of HMG is to service National Interstate Insurance Company's captive insurance programs on an international basis. The duties outlined in the contract include, but are not limited to the following:

- Service insurance policyholder;
- Cancel policies at the customer's request, non-payment of premium or as otherwise directed by the Company;
- Use the Company's policy processing system to issue Insurance policies, binders, endorsements and certificates on forms approved with the Company and filed and approved by regulatory authorities;
- Investigate and adjust claims and set policy reserves in concerning the Company's reinsurance treaties;
- Maintain, at HMG's expense, offices and sufficient staff in number and qualifications to perform the agreement;
- Deposit in a separate and segregated premium account(s) any and all monies received by HMG and remit to the Company amounts due; and
- Reimburse the Company for its payments of any fine, penalty or similar administrative charge assessed against the Company resulting from regulatory enforcement actions premised or connected with HMG's obligations.

Finding: The examiners found no errors in this review.

D. Certificate of Authority

The examiners reviewed the Company's Operations for compliance with their Certificate of Authority to ensure that only those companies with the appropriate authority are transacting the business of insurance in Delaware.

Finding: The Company is operating in accordance with state law.

II. COMPANY OPERATIONS/MANAGEMENT

Since this examination was a targeted review of the Company's rating practices, an in-depth review of the Company's Operations and Management was not conducted during this examination.

III. COMPLAINT HANDLING

The examiners reviewed the complaints received by the Company during the examination period. There were three (3) DDOI complaints reported for the period. The Company stated that there were no direct complaints received. The Company's Complaint Handling Procedures were also reviewed for compliance with Delaware's law.

Finding: No exceptions in Complaint Handling were noted.

Also, the DDOI received a letter regarding the rating of the Company's Commercial Automobile policies. The letter was written by an individual involved in litigation with the Company and a copy of the letter was sent to each state within which the Company has been issued a Certificate of Authority. The letter stated that the Company was using a "pricing model" to determine the rates for public transportation that was not filed with the DDOI. The letter also advised the DDOI that the Company was shifting premium between an insured's policies.

Finding: The examiners reviewed the Commercial Files and found that the Company did not use a "pricing model" on its Delaware policies. The Company used "A" rates for one policy, and for the other files the Company used either the filed Risk Purchase Group rates or the Commercial Automobile rates that were filed with the DDOI. The examiners saw no evidence of the shifting of premium.

IV. UNDERWRITING and RATING

The examiners reviewed the Company's underwriting and rating procedures to determine the Company's compliance with its underwriting guidelines and the rates filed with the DDOI.

Personal Lines

The examiners reviewed the underwriting and rating for Recreational Vehicles, Travel Trailers and companion vehicles.

Finding: No exceptions in handling were noted.

Travel Trailer/Recreational Vehicle and Commercial Active and Terminated policies

The examiners reviewed the Company's Travel Trailer/Recreational Vehicle and Commercial Active and Terminated policies that were in force or terminated during the time frame of the examination. The field sizes were small enough that census reviews were conducted.

Active Files

Travel Trailer/Recreational Vehicles

Field Size:	156
Sample Size:	156
Sample Type:	Census
Number of Files with Errors:	0
Found Error Ratio:	0%

Finding: No exceptions in handling were noted.

Commercial Automobile

Field Size:	10
Sample:	10
Sample Type:	Census
Number of Files with Errors:	6
Found Error Ratio:	60%

Finding: In one instance the Company issued a policy that provided interim vehicle coverage that was part of a rental vehicle insurance program. The policy provided rental car coverage to the insured if one of the insured's vehicles was out of service. This rating plan was not filed with the DDOI.

Finding: In one instance the examiners found that the Company issued a policy that used an 'A rating' process where the basic limits premium did not meet the required amount for the Company. The policy should have been issued and rated within the Company's filed Risk Purchasing Group.

Finding: In two instances the Company did not follow its procedures for underwriting these risks. The policies should have been issued using the Company's filed Risk Purchasing Group rates.

Finding: In two instances the policies were underwritten by a satellite office and the ISO rating procedures were not followed. The failure to use the rates filed with the DDOI results in refunds to the insureds of \$7,828.00 and \$5,988.00.

Recommendation: It is recommended that the Company comply with 18 Del. C. §2503, which requires that rates should be made and adopted and not be excessive, inadequate or unfairly discriminatory; 18 Del. C. §2504(a), which requires every insurer to file its manual, minimum, class rate, rating schedule or rating plan and every other rating rule, and every modification of any of the foregoing which it proposes to use with the DDOI; and 18 Del. C. §2518, which requires every subscriber to a rating organization to adhere to the filing made on its behalf by such organization unless the insurer has written permission from the Commissioner to deviate from such filing.

Recommendation: It is recommended that the Company issue policies according to its filed rating plans, pursuant to 18 Del. C. §2517, which prohibits an insurer from issuing or making a contract or policy except in accordance with the filings in effect for the insurer.

Recommendation: The Company should conduct training regarding the rating of policies for all of its offices to ensure that the Company complies with the rates it has filed pursuant to 18 Del. C. §2504.

Terminated Files

Travel Trailer/Recreation Vehicles

Field Size:	4
Sample:	4
Sample Type:	Census
Number of Files with Error:	0
Found Error Ratio:	0%

Finding: No exceptions in handling were noted.

Commercial Automobile

Field Size:	1
Sample:	1
Sample Type:	Census
Number of Files with Error:	0
Found Error Ratio:	0%

Finding: No exceptions in handling were noted.

CONCLUSION

The examination was supervised by Cynthia M. Amann, MCM with the assistance of Candace Reese.

Respectfully Submitted,

A handwritten signature in cursive script that reads "Cyndy Campbell". The signature is written in black ink and is positioned above a horizontal line.

Cyndy Campbell, CIE, ACS, AIRC, AIAA,
API, AU, AIS, ACP, CCP, MCM
Examiner in Charge