



# AUDITOR GENERAL

WILLIAM O. MONROE, CPA



## CITIZENS PROPERTY INSURANCE CORPORATION

Operational Audit

January 1, 2004, Through October 20, 2005,  
and Selected Actions Taken Through  
December 7, 2005

Members of the Citizens Property Insurance Corporation Board of Governors and the President and Executive Director who served during the audit period are as follows:

John Collins, from August 2005	Edward London, to August 2005
Jeffery A. Cross, to August 2005	Marcos R. Marchena, to August 2005
G. Bruce Douglas, Chair, from August 2005	Jay Odom
Gloria W. Fletcher	William O'Neil, Member and Chair, to August 2005
Cheryl Herrin, from August 2005	Phillip Thomasson, from August 2005
Earl Horton, from August 2005	Julio Rebull, Jr., from August 2005

Robert L. Ricker, President and Executive Director

## Auditor General

The Auditor General provides independent, unbiased, timely, and relevant information to the Legislature, entity management, and the citizens of the State of Florida which can be used to improve the operations and accountability of public entities.

# CITIZENS PROPERTY INSURANCE CORPORATION OPERATIONAL AUDIT

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## CITIZENS PROPERTY INSURANCE CORPORATION

## EXECUTIVE SUMMARY

Citizens Property Insurance Corporation (Citizens) has been established to operate as the State's last resort property insurer. The Legislature's intent, as expressed in Section 627.351(6), Florida Statutes, is that diligent efforts be made to place risks with voluntary insurers and that risks be placed with Citizens only when coverage is not available in the voluntary market. As of November 30, 2005, Citizens had 839,271 policies in force, with annualized premiums of \$1.39 billion and related loss exposures of \$214 billion.

During the storm season of 2004, within a period of seven weeks, four hurricanes struck Florida, with some areas of the State being hit by more than one storm event. In connection with these storms, as of October 20, 2005, a total of 124,997 claims had been submitted by, or on behalf of, Citizens' policyholders, and more than \$2.5 billion in claims had been paid. Citizens experienced significant difficulties in marshalling, maintaining, and managing the resources necessary to timely process these claims, and these difficulties exposed the need for major changes in Citizens' operational approach, particularly with respect to the handling of catastrophe claims.

In response to these difficulties, Citizens' management, and a task force appointed by the Chief Financial Officer, initiated significant changes in Citizens' organizational structure and operations. Also, the Legislature, in Chapter 2005-111, Laws of Florida, has required a complete reexamination and study of the statutory requirements and operations of Citizens. Section 26 of this law required that the Auditor General conduct an operational audit of Citizens, with the scope of the audit to include an analysis of Citizens' infrastructure, customer service, claims handling, accessibility of policyholder information to the agent of record, take-out programs, take-out bonuses, and financing arrangements. The scope was to also include an evaluation of costs associated with the administration and servicing of Citizens' policies to determine alternatives by which costs can be reduced, customer service can be improved, and claims handling improved.

Further, in accordance with an October 19, 2005, letter from the President of the Senate, the scope of the audit included an evaluation of Citizens' standards of conduct and ethical requirements for employees and Board members, hiring practices, background screenings, compensation for employees and consultants, and Board oversight and internal controls over procurement practices.

Our audit disclosed the following:

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*Infrastructure*

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**Finding No. 1: Enterprise Risk Management**

No documentation was available to show that Citizens had conducted an enterprise-wide evaluation of the effectiveness of operational and financial controls. Had Citizens conducted evaluations of controls, the control deficiencies disclosed on audit and described throughout this report may have been subject to more timely identification and correction.

**Finding No. 2: Education and Experience Verifications**

Prior to October 2005, Citizens' human resource policies and procedures did not require the verification of the education and experience claimed by prospective employees, and generally, no such verifications were performed. Absent such verifications, the potential exists for Citizens to have hired as employees individuals who did not possess the appropriate qualifications to carry out the assigned duties.

**Finding No. 3: Background Investigations**

Citizens' procedures did not ensure that background investigations had been performed for all employees at the time of employment. Also, for employees and management, background checks conducted by Citizens had been limited to Statewide criminal correspondence checks and did not include other steps that may identify information that may bear on the employee's suitability for employment. Such other steps may include, for example, fingerprint verification and checks of criminal history data originating at the Federal level and in states other than Florida.

Further, current statute does not require the Office of Insurance Regulation (OIR) to conduct reviews of the backgrounds and business dealings of Citizens' management, officers, and Board members. Such reviews are required for voluntary insurers pursuant to Section 624.404(3), Florida Statutes.

**Finding No. 4: Salary Survey**

Our comparison of the salaries paid Citizens' management and staff to the compensation levels provided to management and employees of voluntary insurers led us to conclude that the salaries paid by Citizens were not excessive.

**Finding No. 5: Standards of Conduct**

Citizens has made progress within the last year in developing effective standards of conduct and related policies and procedures. However, additional steps should be taken to further strengthen the standards of conduct framework. Areas for improvement include, for example, an expanded description of the familial and personal relationships that should be considered a conflict of interest, enhanced requirements for filing annual conflict of interest forms, expanded prohibitions and guidance regarding the receipt of gifts, a methodology to be used to review financial disclosures for indications of actual and potential conflicts of interest, the addition of a requirement that members of the Board of Governors file financial disclosures, and the adoption of policies specifically restricting the use of Citizens' assets to corporate business.

**Finding No. 6: Contractor Selection, Engagement, and Monitoring**

Citizens had not developed and implemented comprehensive written procurement policies and procedures that would provide Citizens' Board and management assurance that vendors would be selected and engaged in a manner that best serves the business interests of Citizens and the public interests of other stakeholders. Deficiencies in contractor selection and contract management policies, procedures, and practices included a lack of documentation showing that potential conflicts of interest on the part of Citizens and prospective contractors had been identified and considered, an absence of competitive procurement, the absence of written contracts, and limited evaluations of contractor performance.

**Finding No. 7: Travel Policy**

As Citizens is a public body created pursuant to law, and as there is no statutory provision of law exempting Citizens from the application of Section 112.061, Florida Statutes, it would appear that the travel and per diem expenses of Citizens must be authorized and paid in accordance with the requirements and rates established by Section 112.061, Florida Statutes. However, our audit tests disclosed that the travel and per diem payments made by Citizens were often not made in accordance with Section 112.061, Florida Statutes.

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*Policy Eligibility Determinations and Depopulation*

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**Finding No. 8: Eligibility Determinations**

Our review of statutes relevant to eligibility determinations and tests of the effectiveness of related Citizens' procedures disclosed that enhancements in some areas may provide additional assurance that Citizens' policies are issued to only those applicants who cannot find insurance in the voluntary market.

**Finding No. 9: Market Assistance Plan**

Although Section 627.3515(1), Florida Statutes, requires that the OIR adopt and operate the Market Assistance Plan (Plan), we found no evidence that the OIR had adopted the Plan, and responsibility for Plan operation and oversight appears to have been assumed by Citizens. Also, historical data was not available to allow a determination of the effectiveness of the Plan. Further, the Plan had not obtained access to certain OIR data that may be helpful in matching those customers seeking insurance to the insurers offering insurance in the voluntary market.

**Finding No. 10: Take-Out Bonuses**

Although Section 627.3511(2), Florida Statutes, appears to limit the amount of bonus that may be paid to an insurer to \$100 for each risk (policy) that the insurer removes, Citizens had developed several programs that provided bonuses of up to \$300 for each policy removed. The bonus amounts paid or escrowed for each policy have averaged \$148. In response to our inquiries, both Citizens and the OIR responded that Section 627.351(6)(g)3.a., Florida Statutes, authorizes the payment of bonuses in excess of \$100 for each policy taken out. That statute provides, "The corporation shall adopt one or more programs subject to approval by the office [Office of Insurance Regulation] for the reduction of both new and renewal writings in the corporation." Citizens should seek legislative clarification of its authority to pay bonuses in excess of the \$100 statutory limit established by Section 627.3511(2), Florida Statutes.

**Finding No. 11: Take-Out Program Long-Term Monitoring**

We found that necessary historical data, such as the complete address of the insured property, was not available for use in an assessment of the long-term effectiveness of the take-out programs. Such data would facilitate an analysis of the extent to which risks, following a take-out period, may be returning to Citizens. Our limited tests did disclose some evidence that risks had been returned to Citizens and then subsequently taken out again by another insurer.

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*Accessibility of Policyholder Information to Agents*

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**Finding No. 12: Policyholder Systems**

For its primary electronic policy administration systems, Citizens had not provided system functionality that allowed agents to electronically transact business, particularly with respect to commercial account and catastrophe claims information. Citizens has initiated the Single System Project, which is to provide improved functionality.

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*Customer Service*

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**Finding No. 13: Complaint Handling Procedures**

Although Citizens had multiple functional units involved in addressing complaints, there was no one functional unit assigned the responsibility for coordinating the receipt and ensuring the timely and effective resolution of policyholder complaints. To improve its complaint handling processes, Citizens plans to establish, effective January 2006, a consolidated complaint unit.

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*Claims Handling*

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**Finding No. 14: Monitoring of Contracted Adjuster Resources**

Because of deficiencies in Citizens' monitoring of its adjuster resources contracted for the 2004 storm season, Citizens did not have a reliable means for determining the extent to which the services provided conformed to Citizens' requirements or a basis for timely identifying performance issues that may have required corrective actions. Although significant procedural improvements have been implemented, additional enhancements continued to be needed.

**Finding No. 15: Catastrophe Claim Files**

For a sample of claims, we determined, with the assistance of an insurance industry consultant, the timeliness with which catastrophe claims had been processed, the extent to which file evidence supported the existence of a loss, the extent to which the described and depicted losses were consistent with the amounts paid, the sufficiency of case reserves, the sufficiency of the steps taken by Citizens to review the findings of the contracted adjusters, and the reasonableness of the fees paid to contracted adjusters. We found:

- Many documents in the 2004 and 2005 claim files were not dated. Notwithstanding the absence of dates in many instances, we were able to determine that for the 2004 storms, there was often a significant lag between the filing of a claim, the assignment of the claim to an adjuster, and the closing of the claim. With respect to the 2005 storm claims reviewed, claims were processed more expeditiously.
- The fees paid by Citizens to contracted adjusters and claims administrators were sometimes high in relation to the services received.
- Few files included an insurance-to-value analysis. Such an analysis facilitates a determination as to whether the property was insured at a level commensurate with the replacement cost of the property. Absent an appropriate level of coverage, the amount due to the policyholder is subject to reduction through the application of a coinsurance penalty. In explanation, Citizens' management stated that because Citizens did not have a consistent valuation methodology available to agents and insureds to help them establish a replacement cost amount, nor an adopted valuation benchmark, it was unfair to impose a coinsurance penalty.
- Case reserves were not always properly maintained and adjusted to reflect the best and most recent estimate of the claim payment that will be due.
- For three claims, the amounts paid appeared to be inconsistent with claim file information.

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*Premiums*

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**Finding No. 16: Actuarial Soundness of Rates**

- Actuarial studies were not available to demonstrate the extent to which the rates assessed through June 30, 2005, were, as required by Section 627.351(6)(d)1., Florida Statutes, actuarially sound.

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*Probable Maximum Loss Financing*

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**Finding No. 17: Financing Options**

In general, we found the approach used by Citizens to provide financing for its estimated 100-year probable maximum loss (PML) to be reasonable. Efforts to reduce the cost-of-carry associated with pre-event bonds should continue. Also, the amount of surplus available to assist in the financing of the 100-year PML could, as addressed in other findings of this report, be increased by assessing and collecting all premiums due under the authority of law; reducing, where possible, loss adjustment expenses; and engaging service providers through competitive means.

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*Other Matters*

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A former employee of Citizens is currently the subject of an ongoing criminal investigation. The outcome of this investigation and its implications, if any, relative to the controls or operations of Citizens was unknown as of the close of our audit field work.

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To promote accountability in government and improvement in government operations, the Auditor General makes operational audits of selected programs, activities, and functions of State agencies. This audit was made in accordance with applicable *Government Auditing Standards* issued by the Comptroller General of the United States. This audit was conducted by Allen Weiner, CPA, and supervised by Don Hancock, CPA. Please address inquiries regarding this report to Don Hancock, CPA, Audit Manager, via email at [donhancock@aud.state.fl.us](mailto:donhancock@aud.state.fl.us) or by telephone at (850) 487-9037.

This report and other audit reports prepared by the Auditor General can be obtained on our Web site (<http://www.state.fl.us/audgen/>); by telephone (850-487-9024); or by mail (G74 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450).

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**BACKGROUND**

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Effective July 1, 2002, pursuant to amendments made to Section 627.351, Florida Statutes, by Chapter 2002-240, Laws of Florida, Citizens Property Insurance Corporation (Citizens) was created to provide, as the State's last resort insurer, residential and commercial property insurance. Pursuant to those amendments, the policies, obligations, rights, assets, and liabilities of both the Florida Residential Property and Casualty Joint Underwriting Association (FRPCJUA) and the Florida Windstorm Underwriting Association (FWUA) became the policies, obligations, rights, assets, and liabilities of Citizens.

In accordance with Section 627.351(6), Florida Statutes, as amended by Chapter 2002-240, Laws of Florida, Citizens' Plan of Operation required that Citizens operate subject to the supervision and approval of a seven-member Board of Governors appointed by and serving at the pleasure of the State Treasurer (Chief Financial Officer, effective January 7, 2003). Also, in accordance with statute, as amended, the Plan of Operation required that Citizens' Executive Director and senior managers be engaged and serve at the pleasure of the Chief Financial Officer and that the Executive Director be responsible for employing other staff as the corporation may require, subject to review and concurrence by the Office of Treasurer.

Chapter 2005-111, Florida Statutes, effective August 1, 2005, provided for revised appointment processes for the Board of Governors, senior management, and staff. Effective August 1, 2005, the Plan of Operation is to require that Citizens operate subject to the supervision and approval of an eight-member Board. The Governor, the Chief Financial Officer, the President of the Senate, and the Speaker of the House are each to appoint two members of the Board, and at least one of the two members appointed by each appointing officer must have demonstrated expertise in insurance. With respect to the appointment of senior management, the statute, as amended, mandates that the Plan of Operation require that Citizens' Executive Director and senior managers be engaged by the Board, as recommended by the Chief Financial Officer, and serve at the pleasure of the Board. The Executive Director is to be responsible for employing other staff as the corporation may require, subject to review and concurrence by the Board and the Chief Financial Officer.

Section 627.351(6)(b)2., Florida Statutes, provides that all revenues, assets, liabilities, losses, and expenses of Citizens are to be divided into three separate accounts, as follows:

- A personal lines account for personal residential policies issued by Citizens or issued by the FRPCJUA and renewed by Citizens. Such policies are to provide comprehensive, multi-peril coverage on risks that are not located in areas eligible for coverage in the FWUA, as those areas were defined on January 1, 2002. The account is to also include policies that do not provide coverage for the peril of wind on risks that are located in such areas.
- A commercial lines account for commercial residential policies issued by Citizens or issued by the FRPCJUA and renewed by Citizens. Such policies are to provide coverage for basic property perils on risks that are not located in areas eligible for coverage in the FWUA, as those areas were defined on January 1, 2002. The account is to also include policies that do not provide coverage for the peril of wind on risks that are located in such areas.
- A high-risk account for personal residential policies and commercial residential and commercial nonresidential property policies issued by Citizens or transferred to Citizens that provide coverage for the peril of wind on risks that are located in areas eligible for coverage in the FWUA, as those areas were defined on January 1, 2002.

The three accounts must be maintained as long as financing obligations entered into by the FRPCJUA or the FWUA are outstanding, in accordance with the terms of the corresponding financing documents. When the obligations are no longer outstanding, a single account may then be used.

Table 1 summarizes by account, as of November 30, 2005, the policies in force, annualized premiums, and exposure:

<b>Table 1</b> <b>Citizens Premium and Exposure Report</b> <b>As of November 30, 2005</b>			
<b>Account</b>	<b>Policies in Force</b>	<b>Premium</b>	<b>Exposure</b>
Personal-Residential	400,573	\$ 505,829,640	\$ 58,200,750,166
Commercial-Residential	3,297	57,556,425	12,125,413,840
High-Risk	435,401	824,687,708	144,121,294,056
Total	839,271	\$1,388,073,773	\$214,447,458,062

The Legislature’s intent, as expressed in Section 627.351(6), Florida Statutes, is that diligent efforts be made to place risks with voluntary insurers and that risks be placed with Citizens only when coverage is not available in the voluntary market. Consistent with this intent, the Legislature has authorized plans and programs to encourage voluntary market coverage of risks and to transfer, through take-out programs, Citizens’ policies to voluntary insurers.

During the storm season of 2004, within a period of seven weeks, four hurricanes struck Florida, with some areas of the State being hit by more than one storm event. In connection with these storms, as of October 20, 2005, a total of 124,997 claims had been submitted by, or on behalf of, Citizens’ policyholders, and more than \$2.5 billion in claims had been paid.

In reflection of the impact of the 2004 storms, Citizens’ audited financial statements for the year ended December 31, 2004, reported the following surplus (deficit) amounts:

<b>Table 2</b> <b>Surplus (Deficit) Amounts by Account</b> <b>GAAP Basis - December 31, 2004</b>	
<b>Account</b>	<b>Amount (In Thousands)</b>
Personal Lines	\$ 208,546
Commercial Lines	27,042
High-Risk	(486,621)
Consolidated	\$ (251,033)

Upon the existence of a deficit, Section 627.351(6), Florida Statutes, authorizes the levy of a regular assessment, and such an assessment has been imposed. After adjustments, the amounts to be generated by the assessment were estimated to total approximately \$515 million.

Citizens experienced significant difficulties in marshalling, maintaining, and managing the resources necessary to timely process the 2004 storm claims, and these difficulties exposed the need for major changes in Citizens’ operational approach, particularly with respect to the handling of catastrophe claims. In response, Citizens’ management and a task force appointed by the Chief Financial Officer initiated significant changes in Citizens’ organizational structure and approach to assigning and monitoring catastrophe claim processing resources.

Also, on January 5, 2005, the Senate President and Speaker of the House of Representatives appointed the Joint Committee on Hurricane Insurance (Committee). Among the matters the Committee was directed to study was Citizens Property Insurance Corporation, including the problems experienced by Citizens in handling claims from the 2004 storms, a potential deficit assessment that may be necessary, and Citizens’ policy growth. In its final report

dated February 25, 2005, the Committee, with respect to Citizens, recommended that the Legislature begin a complete reexamination and study of the statutory requirements and operations of Citizens and identified areas for specific consideration.

Consistent with the Committee's recommendations, Chapter 2005-111, Laws of Florida, required examinations of aspects of Citizens' operations. Those examinations include:

- Section 24 establishes the Task Force on Long-Term Solutions for Florida's Insurance Market. The Task Force is to provide by April 1, 2006, a report addressing hurricane insurance market issues and a variety of issues relating to the operations of Citizens.
- Section 27 directs Citizens' Board of Governors to report on a number of issues, including the impacts of changes implemented as a result of Chapter 2005-111, Laws of Florida, the Board's efforts to depopulate the corporation, further actions that could be taken by the Legislature to improve the availability of residential property coverage in the voluntary and residual markets, actions taken and that should be taken to restructure Citizens, projected surpluses or deficits and the means of providing funding, and efforts taken to purchase catastrophe reinsurance.
- Section 26 required that the Auditor General conduct an operational audit of specified scope.

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**FINDINGS AND RECOMMENDATIONS**

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***Infrastructure***

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Citizens' Board and management have a responsibility for establishing an infrastructure, including a plan of organization, the systems, and the related internal controls that will provide reasonable assurance of the efficient, effective, and economical accomplishment of Citizens' responsibilities, as established by law, contracts, and insurance industry practice.

As described more fully below, and in other sections of this report, we found that many infrastructure improvements have been made and others are in progress. We also found that there remain opportunities for improvement.

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**Finding No. 1: Enterprise Risk Management**

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To provide reasonable assurance of the satisfaction of its statutory responsibilities and accomplishment of its business objectives, Citizens' management should have in place an effective system for identifying, analyzing, and managing risks. Such a system should include the development of specific corporate objectives, the identification of strategies to accomplish those objectives, and an evaluation of operational and financial controls implemented for the purpose of mitigating risks to the accomplishment of the objectives and strategies.

Citizens has developed corporate objectives. However, no documentation was available to show that Citizens had conducted an enterprise-wide evaluation of the effectiveness of operational and financial controls. Absent such evaluations, Citizens may not timely identify control deficiencies and that may leave significant risks unmitigated. Our audit, for those areas included within the legislatively-mandated scope, has identified several areas in which effective controls were not in place. Had Citizens conducted evaluations of controls, these control deficiencies may have been subject to more timely identification and correction.

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**Recommendation: In December 2004, Citizens' Board employed an internal auditor. It is our understanding that the internal auditor had begun the process of conducting risk evaluations. We recommend that Citizens' Board and management, with the assistance of the internal auditor, continue the process of implementing and documenting enterprise risk management processes.**

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**Finding No. 2: Education and Experience Verifications**

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As of December 31, 2004, Citizens employed 351 individuals in a variety of roles, including many, such as insurance underwriters, claims adjusters and examiners, business analysts, and accountants, requiring specific levels of education and experience. To ensure that those individuals selected for employment possess at the time of employment, the education and experience required for the position, Citizens should have policies and procedures in place requiring the verification of the education and experience claimed by the candidates selected for employment.

For employees hired prior to October 2005, Citizens' human resource policies and procedures did not require the verification of the education and experience claimed by prospective employees, and generally, no such verifications were performed. Absent such verifications, the potential exists for Citizens to have hired as employees individuals who did not possess the appropriate qualifications to carry out the assigned duties.

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**Recommendation: Effective October 2005, Citizens has engaged a company to conduct education and experience verifications. We recommend that Citizens monitor this process and ensure that pre-employment education and experience verifications are performed for prospective employees.**

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**Finding No. 3: Background Investigations**

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Since its inception, Citizens' policy has been to conduct background investigations on all managers and employees at the time of employment. However, our review of the design of the policy and tests of compliance with related procedures disclosed the following deficiencies:

- Established procedures did not ensure that background investigations had been performed for all employees at the time of employment. For 2 of the 15 employees included in our tests, Citizens could not provide evidence that the required background investigations had been performed. One of the two employees filled the position of Controller and the other worked as an information technology manager.
- For employees and management, background checks conducted by Citizens had been limited to Statewide criminal correspondence checks. Such background investigations did not include fingerprint verification, checks of criminal history records that would disclose criminal history data originating at the Federal level or in states other than Florida, or other steps that may identify information that may bear on the employee's suitability for employment.
- We found that while the Office of Insurance Regulation (OIR) conducts reviews of the backgrounds and business dealings of the management, officers, and directors of voluntary insurers, the current statute does not require that OIR conduct similar reviews of Citizens' management, officers, and Board members. With respect to voluntary insurers, pursuant to Section 624.404(3), Florida Statutes, the OIR, in granting or continuing a voluntary insurer's authority to transact business, makes determinations through background investigations and other procedures that the insurer's management, officers, and directors are not incompetent or untrustworthy; or so lacking in insurance company managerial experience as to make the proposed operation hazardous to the insurance-buying public; or so lacking in insurance experience, ability, and standing as to jeopardize the reasonable promise of successful operation. Under this statute, the OIR also considers whether an insurer's management, officers, and directors are affiliated directly or indirectly through ownership, control, reinsurance transactions, or other insurance or business relations, with any person or persons whose business operations are or have been marked, to the detriment of policyholders or stockholders or investors or creditors or of the public, by manipulation of assets, accounts, or reinsurance or by bad faith.

In October 2005, Citizens began requiring that a more comprehensive background check be performed for senior management. Also, subsequent to our testing, Citizens proposed changes to its Plan of Operation and those changes require that senior management be made subject to the OIR review procedures applied to voluntary insurer management, officers, and directors, pursuant to Section 624.404(3), Florida Statutes. However, the proposed changes did not include provisions requiring OIR review of members of Citizens' Board of Governors.

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**Recommendation: We recommend:**

- **Citizens' management monitor and enforce compliance with procedures relating to the conduct of background investigations.**
- **Citizens take steps to ensure that the expanded background investigations are completed for all managers and employees in positions of trust or responsibility and that all significant matters disclosed by the investigations are properly addressed.**
- **The Legislature amend Section 627.351(6)(c), Florida Statutes, to require that Citizens' Plan of Operation, consistent with Section 624.404(3), Florida Statutes, require OIR review of the appropriateness of the backgrounds and business dealings of Citizens' Board members, the Executive Director, and senior management.**

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**Finding No. 4: Salary Survey**

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Our audit included research to determine the compensation levels provided to management and employees of voluntary insurers, including a review of a classification and compensation study commissioned by Citizens in July 2003. We also obtained a download of Citizens' payroll data so that we could tabulate the actual salaries paid to Citizens' employees. In determining the salaries paid to Citizens' staff, we did not include as salaries any consulting fees or other compensation that may have been paid by Citizens to individuals prior or subsequent to service as an employee of Citizens.

Our comparison of the salaries paid Citizens' management and staff to the salaries available in the private sector from voluntary insurers led us to conclude that the salaries paid to Citizens' management and employees were not excessive.

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**Finding No. 5: Standards of Conduct**

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It is essential to the proper conduct and operation of Citizens that Board members, management, and employees be independent and impartial and that service in such roles not be used for personal gain. To reasonably ensure the independence and impartiality of Board members, management, and employees, policies and procedures should be established and implemented to address situations where conflicts of interest may be a risk and of significant likelihood.

Our audit, which included a review of Citizens' standards of conduct and related policies and procedures, in effect during the period January 1, 2004, through October 20, 2005, disclosed the following:

- A policy statement, such as a Code of Ethics, setting forth standards of conduct had not been timely adopted and communicated. We noted that, although Citizens as a corporate entity has existed since July 1, 2002, a Code of Ethics was not adopted and put into place until October 20, 2005, when it was approved at a Board of Governors' meeting. An effectively communicated Code of Ethics sets the tone of operation by providing an expression of the expectations of the Board with respect to the conduct and allegiance expected of management and employees.
- The Code of Ethics, as approved October 20, 2005, appropriately includes a description of relationships that would be considered conflicts of interest for Citizens' officers and employees. However, the description is incomplete in that it does not include as potential conflicts of interest familial and other close relationships, beyond an officer's or employee's spouse or child. Familial and other close relationships not addressed by the code include, for example, father, mother, brother, sister, uncle, aunt, father-in-law, mother-in-law, and close personal friend.
- Effective August 1, 2005, Citizens' policies and procedures required each employee to sign a conflict of interest form acknowledging an understanding and agreeing that in accepting employment, the employee could not be involved directly or indirectly in business enterprises that may pose a conflict of interest and that the employee, absent notification of Citizens' management, could not pursue or discuss offers of employment or other offers of financial interest made by any insurance entity or other entity doing business with Citizens. The form also provided a brief description of the conditions under which a conflict of interest is considered to exist. Our review of the reporting processes relating to the conflict of interest policy disclosed the following areas for improvement:
  - As indicated above, the conflict of interest form requires acknowledgment and agreement that the employee will not engage in certain activities that would result in a conflict of interest. The disclosure provided by the form could be improved by requiring that the employee either assert the absence of conflicts of interest or identify the actual or the potential conflicts that do exist. Where conflicts are identified, the information provided could be used by Citizens to alter work responsibilities so that the conflict can be mitigated.

- The policy requires that the form be signed only initially upon employment. As conflicts of interest may develop subsequent to employment, employees should be asked to complete a conflict of interest form on an annual basis, and at any time that a conflict develops.
- With respect to gifts, the Code of Ethics, approved at the Board of Governors meeting on October 20, 2005, provides that no Citizens' officer or employee shall solicit or accept anything of value to the recipient, including a gift, loan, reward, or promise of future employment. Citizens' conflict of interest policy, effective August 1, 2005, and the revised Plan of Operation that was approved on October 20, 2005, by Citizens' Board of Governors, prohibit the acceptance of a gift having a value of more than \$100. Our review of the gift policy disclosed the following amendments that should be considered:
  - Citizens' policies and procedures do not provide a guiding principle to be considered should a gift be offered. Such a guiding principle might provide, for example, that Citizens' employees shall safeguard their ability to make objective, fair, and impartial decisions by not accepting any gift, benefit, or privilege that might appear to influence or reward a specific or future decision.
  - The term "gift" is not defined by the policy. To avoid any confusion with respect to the application of the policy, the term should be defined and examples should be provided as to what does and does not constitute a gift.
  - There is no requirement that gifts be reported. To strengthen the policy, a reporting requirement should be adopted.
  - All gifts should be prohibited, not just those having a value of \$100 or more. The receipt of a gift of any value carries with it the potential for being perceived as a conflict of interest.
- Prior to October 20, 2005, no post-employment restrictions were in place for Citizens' officers and employees. Subsequent to that date, the Plan of Operation and the Code of Ethics prohibit senior management, the Executive Director, and members of the Board of Governors from personally representing another person or entity for compensation before the Board or Corporation for a period of two years following vacation of position.
- Prior to October 20, 2005, Citizens did not require that any Citizens' official file financial disclosure statements. Subsequent to that date, the Plan of Operation and Citizens' Code of Ethics require that the Executive Director and senior management file a financial disclosure statement substantially in the same form required of State employees pursuant to Section 112.3144, Florida Statutes. However, the policy and procedure guidance does not specify the methodology to be used to review the disclosures for indications of actual and potential conflicts of interest or identify a repository for the completed financial disclosure forms. We also noted that the financial disclosure requirement, as adopted, does not extend to members of the Board of Governors. It was not clear why financial disclosure requirements should not be extended to include members of the Board.
- Citizens' policies and procedures do not specifically limit the use of Citizens' assets to corporate business.
- Florida Statutes currently do not include provisions which specifically require that Citizens adopt, implement, and enforce standards of conduct. The standards of conduct framework in place as of the close of our audit field work had been put into place through Board action. The Legislature could further emphasize the importance of the standards by adopting laws specifically requiring their establishment and enforcement. The adoption of such law may also better facilitate the specification of civil penalties that may be enforced in the event that standards of conduct are violated.

Absent the adoption, implementation, communication, and enforcement of rigorous standards of conduct and related policies and procedures, there may be reduced assurance that Board members, management, and employees will perform their duties in an independent and impartial manner and that Citizens' resources will be safeguarded and used for the limited purposes authorized by law.

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**Recommendation:** Much has been done within the last year to develop effective standards of conduct and related policies and procedures. We recommend that those efforts continue and that the following additional steps be taken to further strengthen the standards of conduct framework:

- The Code of Ethics should be amended to include an expanded description of the familial and personal relationships that should be considered a conflict of interest.
- Policies and procedures should be amended to require that each manager and employee file a conflict of interest form annually and any time a conflict develops, providing either a statement that no conflicts exist or a description of the actual or potential conflicts that do exist.
- Gift policies and procedures should be amended to prohibit the receipt of all gifts, include a statement of guiding principle, and provide a more specific definition of the term “gift.” Should gifts be allowed, reporting requirements should be established and enforced.
- Financial disclosure statement filing procedures should be amended to specify the methodology to be used to review the disclosures for indications of actual and potential conflicts of interest and identify a repository for the completed financial disclosure forms. The policy should also be expanded to include members of the Board of Governors.
- Policies and procedures should specifically restrict the use of Citizens’ assets to corporate business.
- The Legislature should amend Section 627.351(6)(c), Florida Statutes, to require that Citizens’ Plan of Operation include provisions addressing standards of conduct and that those standards be patterned after Part III, Chapter 112, Florida Statutes (the Code of Ethics for Public Officers and Employees). Section 627.351(6)(c), Florida Statutes, as amended, should include specification of penalties assessable in the event that ethics requirements are violated.

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**Finding No. 6: Contractor Selection, Engagement, and Monitoring**

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Fair and open competition reduces the appearance of and opportunity for favoritism and inspires public confidence that contractors are selected and contracts are awarded in a manner which is ethical and which yields the services required at the best available value. Documentation of the procurement actions taken is also an important means of curbing any improprieties and establishing confidence in the procurement process.

To reasonably ensure fair and open competition and the ability of management to consistently demonstrate that contractual services have been procured utilizing good business practices and in a manner best serving the interests of stakeholders, it is essential that there be a system of uniform written contracting procedures. Those policies and procedures should require that competitive procurement processes be used and specify those few exceptional circumstances, such as emergencies, under which the competitive selection of service providers would not be required. The procedures should address approval authority for contracts and the approvals and justification required for purchases that cannot be made on a competitive basis. The procedures should also address the different means of competitive procurement and the associated procedural and documentation requirements. Further, the procedures should require disclosure of potential conflicts of interest on the part of all involved in procurement, including Board members, Citizens’ employees, and prospective service providers. Finally, to ensure clarity with respect to the agreed-upon terms and conditions of engagements, Citizens’ policies and procedures should require that, at a minimum, all major contracts be reduced to writing.

Following the selection of a contractor and the negotiation of a contract, Citizens is responsible for taking those steps necessary to ensure that the contractor performs satisfactorily. To provide assurance that contractor performance



conforms with the terms of contracts, Citizens' policies and procedures should require that the performance of contractors be monitored, that the monitoring efforts be documented, and that the resulting measurements of performance be considered should the contractor be evaluated in connection with the award of other projects.

Our audit disclosed that written procurement policies and procedures had not been developed and implemented. The absence of written procurement policies and procedures contributed to the following instances in which deficiencies in contractor selection and contract management were disclosed by our audit:

- In December 2003, Citizens issued a solicitation and used the results of the competitive process to select and contract with 14 adjusting firms. In May 2005, Citizens issued another solicitation seeking adjuster services and subsequently contracted with 31 adjusting firms. As of December 7, 2005, these 45 adjusting firms had been paid a total of approximately \$83 million. Our review of these procurements and the related selection processes disclosed:
  - Citizens did not, for the 2004 and 2005 adjusting firm selection processes, require the individuals on the selection team to attest in writing that they were independent of, and had no conflict of interest with respect to, the entities evaluated and selected. Such attestations help to ensure, in fact and appearance, a fair and open procurement process.
  - Citizens did not include in the solicitations a requirement that all potential conflicts of interest be disclosed by respondents. Similarly, we noted that the criteria utilized by Citizens to evaluate responses did not require a consideration of the existence of conflicts of interest on the part of respondents. Absent such disclosures, vendors with conflicts of interest may be inappropriately engaged.
  - Documentation relating to the adjusting firm selections made in connection with the December 2003 solicitations did not include scoring sheets completed by each selection team member and an overall tabulation summarizing the selection process. Citizens' staff indicated that the selection team had met and made its selection decisions verbally and that no report had been prepared to summarize and document the selection team's deliberations. Absent the availability of documentation showing the evaluations of individual team members and the process used to identify and select the finalists, Citizens cannot fully demonstrate the extent to which a fair and open procurement process had been used to select contractors most qualified in terms of capability and price.
  - With respect to the May 2005 solicitation, pursuant to which 31 adjusting firms were retained, we were provided with completed scoring sheets; however, they were not signed and dated. We also noted that the 2004 performance of the adjusting firms was not considered in awarding adjusting firm contracts for 2005. All firms responding to the May 2005 solicitation and judged by Citizens to have met the minimum qualifications were awarded a contract.
- To address the workload associated with the 2004 storms, Citizens, without the employment of competitive processes, procured claims adjusting services from an additional 23 firms. Citizens also procured claims adjusting services from 9 firms in 2005 without use of competitive processes. Amounts paid to these 32 firms totaled approximately \$20 million, as of December 7, 2005. The retention of many of these firms may have been justified because of the existence of an emergency; however, we found no documentation showing that either Citizens' Board or the Executive Director had, in advance, approved the hiring of these firms on a noncompetitive basis. Our audit also disclosed that Citizens did not reduce to writing its contracts with any of the 23 firms noncompetitively selected in 2004. Citizens' staff indicated that Citizens faxed fee schedules to these adjusting firms and, following verbal agreement, the firms were assigned claims for adjustment. Matters not addressed by contract, verbal or otherwise, included the compensation to be paid in connection with any subsequent inspections, a requirement that the adjuster maintain a current State of Florida adjuster license, the time frames within which adjuster duties must be performed, the records that were to be maintained by the

adjusting firm, provisions guaranteeing access to claims records and related documents, and provisions addressing performance bonuses and penalties.

- From June 2004 through April 2005, according to Citizens' accounting records, a total of \$393,240 was paid to Saucon Valley Consultants for services rendered from May 3, 2004, through February 1, 2005. According to invoices provided for our review, the work performed included identifying improvements in claims processing (\$94,600), catastrophe claims services (\$157,740), and damage inspection at Sanibel and Captiva Islands (\$126,100). The invoices also included charges (\$14,800) identified as daily billing rates for specified individuals. The specific nature of the services provided by these individuals was not described by the invoices.

We were provided with a contract between Citizens and Paul Hulsebusch,<sup>1</sup> who at the time owned Saucon Valley Consultants, and that contract included within its scope the identification of improvements in claims processing. However, the contract did not address the provision of the other services for which Saucon Valley Consultants was paid. The issues that might have been addressed in such a contract would have included a clear description of the consultant's specific responsibilities, duties, and authority; the extent to which the consultant, in the provision of services, was to conform to Citizens' policies and procedures, including those relating to conflicts of interest; the term of the agreement; and provisions governing the compensation due for the provision of services.

- According to Citizens' personnel, Citizens' former Chief Operating Officer entered into a verbal contract with a contractor for the performance of a quality control audit of a sample of 4,362 hurricane claims filed in connection with 2004 storms, including on-site reinspections of the losses. In compensation, Citizens paid the contractor approximately \$1.4 million. Citizens also paid the contractor an additional \$386,983 for adjusting services relating to supplemental payments made on the reinspected claims. We found no evidence that the contractor had been selected through competitive means, no written contract between Citizens and the contractor, and no evidence that the contract had been approved by Citizens' Board or its Executive Director. Upon further review, we also noted the existence of an apparent conflict of interest in that an affiliate of the contractor had provided claims adjusting services for approximately 11,000 (9 percent) of the approximately 125,000 claims for 2004 hurricanes. As a consequence, the contractor had been engaged to evaluate an affiliate's work, as well as the work of competitors of the affiliate. Further, since the contractor conducted its field work during the period January 24, 2005, through May 20, 2005, it was not clear that the added expense of on-site reinspections was justified, as many of the subject properties would have already been repaired at the time of the reinspections.
- For 17 of the other contractual relationships reviewed, involving the provision of such services as policy processing, printing of billings and endorsements, actuarial services, and investment management services, and under which payments during the period January 1, 2004, through September 30, 2005, totaled approximately \$33 million, we found:
  - For 16 of the 17 contractual relationships, no documentation showing that the contractor had been selected through competitive means or, alternatively, that circumstances, such as an emergency or sole source availability, made a competitive selection process impracticable. In some of these instances, the contractual relationships had been established by one of Citizens' predecessor organizations, and rather than pursuing a service provider through competitive processes, Citizens had retained, renewed, or renegotiated the existing contracts.
  - For the 10 instances in which cost-benefit comparisons were advisable, no documentation of a comparison of the costs and benefits of providing the service in-house to the costs and benefits of outsourcing the work.
  - For 9 of the 13 instances in which contractor evaluations would have been useful, no documentation showing that the contractor's performance had been of record evaluated.

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<sup>1</sup> From January 31, 2005, through September 9, 2005, Mr. Paul Hulsebusch was employed as Citizens' Chief Operating Officer.

Absent the adoption and use of comprehensive purchasing policies and procedures, Citizens' Board and management have less assurance that vendors will be selected and engaged in a manner that best serves the business interests of Citizens and the public interests of other stakeholders.

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**Recommendation:** As of November 2005, Citizens had under development procurement policies and procedures. We recommend that development, Board review and approval, and implementation of appropriate policies and procedures be expedited and that the approved policies and procedures require:

- Absent exceptional circumstances, the competitive selection of contractors.
- Specification of the exceptions to a competitive selection requirement and the justification, Board and management approvals, and documentation required prior to a noncompetitive vendor selection.
- For various estimated procurement cost levels, specification of the required competitive procurement methods (for example, verbal quotes, requests for proposal, and sealed invitations to bid), the related documentation, and the level at which approval authority vests (for example, the Board, Executive Director, or other senior management).
- Written contracts embodying all terms and conditions of the agreement between Citizens and the contractor.
- For each contracting opportunity, a written assertion on the part of those involved, including applicable members of Citizens' Board, Citizens' employees, and potential contractors, that no conflicts of interest exist.
- In each written contract, the inclusion of a clause voiding the contract at the option of Citizens should conflicts of interest be identified.
- For major contracts, comparisons of the costs and benefits of providing the service in-house to the costs and benefits of outsourcing of the work.
- Periodic evaluations of the performance of contractors.

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#### **Finding No. 7: Travel Policy**

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Section 112.061, Florida Statutes, governs for public agencies the authorization and payment of the per diem and travel expenses of public agency officers, employees, and others, such as consultants and other contractors, who are authorized by the agency head to incur travel expenses in the performance of official duties. Section 112.061, Florida Statutes, defines a public agency as, "Any office, department, agency, division, subdivision, political subdivision, board, bureau, commission, authority, district, public body, body politic, county, city, town, village, municipality, or any other separate unit of government created pursuant to law."<sup>2</sup> As Citizens is a public body created pursuant to law (that is, Part I of Chapter 627, Florida Statutes) and as there is no statutory provision of law exempting Citizens from the application of Section 112.061, Florida Statutes, it would appear that the travel and per diem expenses of Citizens must be authorized and paid in accordance with the requirements and rates established by Section 112.061, Florida Statutes.

Our audit tests disclosed that the travel and per diem payments made by Citizens were often not made in accordance with Section 112.061, Florida Statutes. For example, Section 112.061, Florida Statutes, provides that the amounts paid

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<sup>2</sup> The Attorney General's Office has interpreted this statute broadly to apply to a number of entities created by statute. See, for example, Attorney General's Opinion Nos. 77-117 (Planning Council), 79-3 (Utilities Authority), 79-76 (Student Government Association), 80-3 (Community College), 82-34 (County Planning Council), 89-42 (County Hospital District), 92-67 (Board of County Commissioners), and 99-33 (Riviera Beach Housing Authority).

for breakfast, lunch, and dinner shall be \$3, \$6, and \$12, respectively, and the amounts to be paid for transportation expense associated with the use of personal vehicles shall be 29 cents per mile. Prior to October 2005, Citizens' business expense report form provided for payment of the actual cost of meals and for personal vehicle usage payments at the rate of 38 cents per mile. Effective October 2005, Citizens' Travel and Travel Reimbursement Policy provides for breakfast, lunch, and dinner, payments of \$10, \$15, and \$25, respectively, and for the use of personal vehicles, mileage payments at the rate allowed for Federal income tax purposes (40.5 cents for 2005).

Citizens' authority for the authorization and payment of travel expenses at rates different from those authorized by Section 112.061, Florida Statutes, was not clear. Absent compliance with the provisions of Section 112.061, Florida Statutes, the amounts paid by Citizens for travel expenses incurred by Citizens' staff, consultants, and contractors were likely significantly in excess of the amounts due pursuant to law.

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**Recommendation:** We recommend that Citizens amend its travel reimbursement policy in such a manner as to make it consistent with the provisions of Section 112.061, Florida Statutes.

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**Follow-up to Management Response:**

*In response to this finding, Citizens indicated that there is no provision in Citizens' enabling legislation that applies State travel reimbursement policy to Citizens and that, if the policy were applied, it would be impossible for Citizens to compete for scarce catastrophic adjusting resources. We agree that the enabling legislation does not specifically cite the applicability of Section 112.061, Florida Statutes, to Citizens' operations. However, as indicated in our finding, Citizens does appear to meet the definition of public agency, as that term is defined for the purposes of Section 112.061, Florida Statutes, and the enabling legislation does not exempt Citizens from the application of Section 112.061, Florida Statutes. Given Citizens' unique responsibilities, we recommend that the Legislature clarify its intent with respect to the applicability of Section 112.061, Florida Statutes, to the operations of Citizens.*

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### *Policy Eligibility Determinations and Depopulation*

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As indicated in the Background section of this report, Citizens was established by the Legislature to serve as a last resort property insurer. Toward that end, various statutes have been adopted to restrict Citizens' policy availability to those insurance applicants who cannot locate coverage in the voluntary market and to maximize the number of Citizens' policies that are transferred to the voluntary market. As described in more detail below, our audit disclosed that these policy eligibility determination and depopulation processes could be improved.

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**Finding No. 8: Eligibility Determinations**

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Section 627.351(6)(a)2., Florida Statutes, states that Citizens shall provide insurance for residential and commercial property for applicants who are in good faith entitled, but are unable, to procure insurance through the voluntary market. Further, Citizens' Plan of Operation, consistent with the requirements of Section 627.351(6)(c)5., Florida Statutes, provides that if a potential insured is offered coverage in the voluntary market, the potential insured is not eligible for any policy issued by Citizens. Our audit provided indications that Citizens' policies may have been issued to some applicants who may have been able to obtain coverage in the voluntary market.

First, we found that new Citizens' policies were being issued in areas of the State in which there appeared to be an active voluntary market. For example, as shown in **Appendix A**, during the last quarter of 2004, in some counties in which Citizens issued new policies, there also were numerous voluntary insurers issuing new policies. While we understand that many of the approximately 96,000 new Citizens' policies may have been for risks that only Citizens would insure (for example, approximately 23,000 of the policies were for Wind-Only coverage), there did appear to

remain, particularly in some counties, a significant possibility that coverage in the voluntary market was available for risks for which Citizens' policies had been issued.

Secondly, 38 of the 61 policyholders responding to our customer service survey reported that, prior to receiving a policy from Citizens, they had not received refusals of coverage from voluntary insurers. Another 11 of those policyholders responding reported that they had received only one refusal of coverage prior to receiving a policy from Citizens.

Our review of statutes relevant to eligibility determinations and tests of the effectiveness of related Citizens' procedures disclosed that enhancements in some areas may provide additional assurance that only those applicants who cannot find insurance in the voluntary market are being issued Citizens' policies. Specifically:

- As required by Section 627.351(6)(c)5., Florida Statutes, Citizens' Plan of Operation requires that, if a potential insured is offered coverage in the voluntary market, the potential insured is not eligible for any policy issued by Citizens. However, there is no requirement that the agent or the customer actively seek offers from voluntary market insurers; all that is required is the absence of an offer.
- As required by Section 627.351(6)(c)15., Florida Statutes, Citizens' Plan of Operation includes provisions allowing the appointment as a Citizens' agent, only those agents who have an appointment with a voluntary insurer which, at the time of the agent's initial appointment by Citizens, is authorized to write and is actually writing policies in the State of Florida. Neither the statute nor the Plan of Operation require that the appointment be with an insurer which is actually writing policies in the agent's geographic area of operation or that appointments with voluntary insurers be maintained following initial appointment as a Citizens' agent. Absent the maintenance of appointments with voluntary insurers writing policies in the agent's geographic area of operation, the agent can only write Citizens' policies and may be less likely to actively investigate the extent to which voluntary market coverage may be available to a customer. Our tests identified five agents who were writing new business for Citizens only. A review of OIR information disclosed that during the quarter ended December 31, 2004, voluntary market insurers were issuing new policies in the counties served by these agents.
- Citizens has, through its Agent Appointment Agreement and its insurance application, provided mechanisms for determining applicant eligibility under governing Florida Statute. Citizens' standard agent appointment agreement provides that, "The Agency and each Agent shall use reasonable efforts to place personal or commercial insurance applicants with an authorized insurer which has insurance rates and forms filed with and approved by the Department (now the Office of Insurance Regulation) prior to placing such risk with Citizens and that no Agent may place a risk with Citizens if the Agent is aware of the existence of an offer of coverage in the private market." Citizens' insurance application requires certification by the agent and the potential insured that there was no offer of coverage in the voluntary market. To ensure the effectiveness of eligibility determination procedures, Citizens' management should periodically measure how well the procedures are working. We were provided with no evidence to show that such measurements had been made.

Absent the existence and enforcement of sufficiently rigorous statutory eligibility determination requirements, Citizens' policies may be issued to risks for which coverage is available in the voluntary market.

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**Recommendation: We recommend:**

- **The Legislature consider amending Section 627.351(6)(c)5., Florida Statutes, to require that agents be made responsible for actively pursuing offers from voluntary market insurers.**
- **The Legislature consider amending Section 627.351(6)(c)15., Florida Statutes, to require that those appointed as Citizens' agents be required to maintain appointments with insurers actively writing new policies in the agent's geographic area of operation. Amendments to this provision of law should also**

address allowable exceptions in the event that such appointments are not available through a reasonable number of insurers.

- Citizens' management periodically evaluate the effectiveness of eligibility determination procedures and advise the Legislature of changes in statute that may more reasonably ensure that the procedures effectively limit the issuance of policies to only those who cannot obtain coverage in the voluntary market.

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**Finding No. 9: Market Assistance Plan**

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Section 627.3515, Florida Statutes, establishes the Market Assistance Plan (Plan) and requires the OIR to adopt a Plan to assist in the placement of risks of applicants who are unable to procure property or casualty insurance from authorized insurers when such insurance is otherwise generally available from insurers authorized to transact and write that type and class of insurance in this State. Section 627.3515, Florida Statutes, also requires that, through such measures as are found appropriate by the Plan's Board, the Plan shall take affirmative steps to assist in the removal from Citizens any risk that can be placed in the voluntary market. Pursuant to statute, each person serving as a member of Citizens' Board of Governors also serves as a member of the Plan's Board of Governors.

Pursuant to Section 627.3515(2)(b), Florida Statutes, the Plan is to be funded through payments from Citizens and annual assessments of residential property insurers in the amount of \$450 each. Both Plan revenues and expenses for the 2004 calendar year were reported at approximately \$267,000.

The Plan provides a variety of programs for consumers, agents, and insurance companies. During calendar year 2005, the Plan provided agents with the names of over 26,000 customers who were trying to obtain insurance. There were approximately 350 agents participating in the Plan.

Our audit disclosed:

- Section 627.3515(1), Florida Statutes, requires that the OIR adopt and operate the Plan. We found no evidence that the OIR had adopted the Plan, and responsibility for Plan operation and oversight appears to have been assumed by Citizens. Absent OIR adoption of the Plan and active involvement in its oversight and operation, it was not clear that the Plan's organization and operation were consistent with legislative intent.
- Historical data was not available to allow a determination of the effectiveness of the Plan. While information was available to show how many referrals had been provided to agents, data had not been gathered through surveys or other means to show the number of voluntary insurer policies written as a result of the referrals.
- The Plan had not obtained access to certain OIR data that may be helpful in matching those customers seeking insurance to the insurers offering insurance in the voluntary market. On a quarterly basis, the OIR receives reports from each voluntary insurer showing for each applicable county the number of new policies written by that insurer. This information could be summarized by county to show the name of each voluntary insurer, which, on a relatively recent basis, has been issuing policies. The availability of this information on the Plan's Web site would provide agents and customers with an efficient means for obtaining the names of voluntary insurers which may be able to provide desired coverages. The information shown on **Appendix A** was derived from the referenced OIR data.

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**Recommendation: We recommend that:**

- **As required by Section 627.3515(1), Florida Statutes, the OIR assume greater responsibility for the operation of the Market Assistance Plan.**

- The Plan obtain and compile information that may allow a measure of the Plan’s success in placing risks in the voluntary market.
- For posting on its Web site, the Plan consider obtaining from the OIR appropriately detailed summaries of the quarterly voluntary insurer reports.

**Finding No. 10: Take-Out Bonuses**

In an effort to encourage the return of policies to the voluntary market, Section 627.3511, Florida Statutes, authorizes voluntary insurers to take out Citizens’ policies. When policies are taken out by a voluntary insurer, the Citizens’ policy is either replaced with a policy of the voluntary insurer or the voluntary insurer may assume Citizens’ obligations with respect to an in-force policy.

To encourage voluntary insurers to take out policies, Section 627.3511(2), Florida Statutes, provides that Citizens shall pay the sum of up to \$100 to an insurer for each risk taken-out. Section 627.3511(2), Florida Statutes, further provides that, in order to qualify for the bonus, the take-out plan must include a minimum of 25,000 policies. Take-out plans of voluntary insurers are subject to the approval of Citizens’ Board and the OIR. According to Citizens’ records, since 1996, 1,389,869 policies had been removed by take-out for which Citizens paid in bonuses or escrowed approximately \$206 million.

Our review of Citizens’ files disclosed that since July 2003, Citizens had removed 386,479 policies from the PLA account and 51,183 policies from the HRA account. **Table 3**, below, summarizes the policies taken out from July 1, 2003, through October 4, 2005.

<b>Table 3</b>		
<b>Policy Take-Outs</b>		
<b>July 1, 2003, through October 4, 2005</b>		
<b>Calendar Year</b>	<b>PLA Policies</b>	<b>HRA Policies</b>
2003	28,219	-
2004	149,795	12,457
2005	208,465	38,726
Total	386,479	51,183

Source: Citizens’ May 25, 2005, Take-Out Program data-file.

As indicated above, the provisions of Section 627.3511(2), Florida Statutes, appear to limit the amount of bonus that may be paid to an insurer to \$100 for each risk (policy) that the insurer removes. Our audit disclosed that Citizens had developed several programs that provided bonuses of up to \$300 for each policy removed, and the bonus amounts paid or escrowed for each policy have averaged \$148.

In response to our inquiries, both Citizens and the OIR responded that Section 627.351(6)(g)3.a., Florida Statutes, authorizes the payment of bonuses in excess of \$100 for each policy taken out. That statute provides, “The corporation shall adopt one or more programs subject to approval by the office [Office of Insurance Regulation] for the reduction of both new and renewal writings in the corporation.” It was not clear to us that this provision of law authorized bonus payments in excess of the \$100 limit specifically established by Section 627.3511(2), Florida Statutes.

**Recommendation:** We recommend that Citizens seek legislative clarification of its authority to pay bonuses in excess of the \$100 statutory limit established by Section 627.3511(2), Florida Statutes.

**Follow-up to Management Response:**

*In response to this finding, Citizens indicated that current statutory authority, that is, Section 627.351(6)(g)3.a., Florida Statutes, enacted after Section 627.3511(2), Florida Statutes, provides clear authority for depopulation programs other than that provided for in Section 627.3511(2), Florida Statutes. We agree that the authority for the adoption of other depopulation programs is clear. However, notwithstanding the timing of the adoption of these two different statutes, it is not clear that such authority provides Citizens with the power to pay bonuses in excess of the expressed limit established by Section 627.3511(2), Florida Statutes. We continue to recommend that Citizens seek legislative clarification.*

**Finding No. 11: Take-Out Program Long-Term Monitoring**

As indicated above in **Table 3**, Citizens has had success with the removal of policies on a year-to-year basis. A risk to the success of the program, however, would be the return to Citizens of the previously taken-out risks. Generally, insurers which take out policies must retain those policies for a three-year period to qualify for the payment of related bonuses. However, following the expiration of the three-year term, the voluntary insurer may cancel or not renew the policy, potentially resulting in the return of that risk to Citizens.

A complete assessment of the effectiveness of the take-out programs cannot be made, absent an analysis of the extent to which risks, following a take-out period, may be returning to Citizens. Consequently, our audit included an attempt to determine how frequently risks may be returning to Citizens. However, we found that necessary historical data, such as the complete address of the insured property, was not available for use in such an analysis.

Our limited tests did disclose that there was some evidence that risks were returning to Citizens. Analysis of the take-out data provided to us by Citizens indicated that there were approximately 2,900 potential matches between the risks identified on the take-out listing of one insurer and those subsequently taken out by another insurer.<sup>3</sup> Such matches indicate that these risks, following an initial take-out period, had returned to Citizens and then were subsequently taken out again by another insurer.

**Recommendation:** We recommend that Citizens ensure that a complete property address is maintained for all insured properties and that this information also be maintained for all properties that are removed by take-out agreements. This information should be used periodically by Citizens to assist in the measurement of how well the take-out programs are working to permanently remove risks from Citizens.

**Follow-up to Management Response:**

*In response to this finding, Citizens indicated that there is no current provision in law that a take-out company permanently remove risks from Citizens and that it would be illogical, time-consuming, and expensive to develop a complex individual property address tracking system. We agree that there is no statute requiring the permanent removal of risks. However, the point of our finding is that absent some knowledge of how frequently risks previously taken out are returning to Citizens, Citizens lacks information useful to a complete evaluation of the effectiveness of its take-out programs. Knowledge as to how often and why risks return may be useful in the validation of current programs and the design of new ones. Our finding did not suggest the development of a tracking system, but that Citizens maintain for each insured property complete addresses that could be periodically matched to identify returning risks.*

<sup>3</sup> The match was accomplished by creating in our copy of the file a field containing a combination of the risk's zip code, the first 12 characters of the insured's name, and the street number.



***Accessibility of Policyholder Information to Agents***

Approximately 7,000 agents serve Citizens’ customers. Agents and others responding to our surveys and interviews reported that an agent’s ability to cost-effectively serve customers is greatly enhanced when the agent is provided the ability to electronically transact insurance business, including such tasks as obtaining insurance policy ratings and quotes, filing applications for new or renewal insurance policies, determining existing insurance coverages and policy status, filing policyholder claims, and determining the current status of the claims which have been filed.

**Finding No. 12: Policyholder Systems**

In addition to an electronic catastrophe claims tracking system, Citizens utilizes three primary electronic policy administration systems. The ePAS system is used for personal lines account policies; the eWind system is used for high-risk account policies; and the CSC System is used for commercial lines policies. As shown by **Table 4**, our audit disclosed that, particularly with respect to commercial account and catastrophe claims information, Citizens had not provided system functionality that allowed agents to electronically transact business.

<b>Table 4</b> <b>Agents</b> <b>Electronic Access to Policyholder Information</b> <b>As of October 2005</b>				
	ePAS System	eWind System	CSC System	Catastrophe Claims Tracking System
	Personal Lines Accounts	High-Risk Accounts	Commercial Accounts	All Accounts
Rating and Quotes	Yes	Yes	No	
Applications and Renewals	Yes	No	No	
Policy Status	Yes	Yes	No	
NonCat Claims Filing & Status	Yes		No	
Catastrophe Claims Filing & Status				No

We interviewed and surveyed a sample of Citizens’ agents to, in part, measure the level of agent satisfaction with the availability of policyholder information. Those interviews and surveys disclosed:

- Agents were generally satisfied with the ePAS System.
- Agents favored providing for the high-risk accounts the same functionality as was available for personal lines accounts. Of particular interest was the functionality that would allow the electronic submission of applications. The agents reported that, although copies of high-risk policy applications were available on-line, the applications could not be filed electronically. The high-risk account applications had to be downloaded, completed off-line, and then printed and mailed or faxed to Citizens.
- With respect to the availability of commercial policyholder information, some agents were not satisfied with the CSC System. Agents reported that information had to be obtained by telephone and that applications for insurance policies or changes to insurance policies had to be manually processed.
- Although most agents did not report problems relating to the filing of catastrophe claims for policyholders, there were concerns relating to the lack of on-line access to the status of catastrophe claim information. For an agent to assist a policyholder with determining the status of such a claim, the agent was required to contact by telephone either Citizens or the assigned adjuster.

Citizens has initiated the Single System Project (SSP), which will over time result in the elimination of the eWind System and the CSC System and provide ePAS System functionality for all policies. The SSP is scheduled for completion in January 2008, with policy migration from the eWind System to the ePAS System to begin in July 2006.

Further enhancements to Citizens’ current systems are also under consideration. Among the enhancements being considered is one that would provide agent access to catastrophe claim functions.

**Recommendation:** To the extent practicable, we recommend that Citizens expedite the SSP and the enhancements necessary to provide agents with the ability to electronically file and view the status of catastrophe claims.

*Customer Service*

Citizens, like other insurance companies, provides customer service that ranges from the issuance of policies to the payment of claims. To measure the degree of customer satisfaction with the level of services provided by Citizens, we mailed surveys to 392 policyholders. Questions were included in the survey to address customer satisfaction with services relating to policy issuance, policy renewal, and claims handling. We also included questions to measure policyholder satisfaction with Citizens’ call center operations and the services provided by Citizens’ agents. Sixty-two policyholders responded to our survey. Our evaluation of the survey results, as shown by **Table 5**, indicated that most policyholders were satisfied with the services received from Citizens, the call center, and Citizens’ agents. However, a significant number of the policyholders who had filed claims relating to 2004 storm losses were dissatisfied with their claims handling experiences.

<b>Table 5</b>					
<b>Customer Service Survey</b>					
	<b>Somewhat Dissatisfied to Dissatisfied</b>		<b>Satisfied to Very Satisfied</b>		<b>Total Responses <sup>(1)</sup></b>
	<b>Number</b>	<b>Percentage</b>	<b>Number</b>	<b>Percentage</b>	
Policy Issuance	10	17%	50	83%	60
Policy Renewal	7	12%	51	88%	58
Agent Service	9	16%	49	84%	58
Call Center Operations	7	17%	33	83%	40
Claims Handling	14	32%	30	68%	44

Note: (1) Not all 62 respondents responded to all questions.

Customer dissatisfaction with Citizens’ processing of 2004 storm claims is also evident from an analysis of customer service complaints (service requests) reported to the Department of Financial Services (DFS), Division of Consumer Services. As shown in **Table 6**, complaints were reported for approximately 8 percent of the claims filed by Citizens’ customers. The complaint rate experienced by the balance of the industry was approximately 3 percent.

<b>Table 6</b>			
<b>Analysis of 2004 Storm Claims and Complaints</b>			
<b>Entity</b>	<b>2004 Storm Claims</b>	<b>2004 Complaints<sup>(3)</sup></b>	<b>Percent Complaints to Claims</b>
All Other Insurance Companies	1,492,984 <sup>(1)</sup>	48,234	3.2%
Citizens	124,997 <sup>(2)</sup>	9,468	7.6%
Total	<u>1,617,981</u>	<u>57,702</u>	

Sources:

(1) OIR Hurricane Reporting Summaries, as of March 3, 2005.  
 (2) Citizens' records, as of October 20, 2005.  
 (3) DFS, Division of Consumer Services, as of November 8, 2005.

We also analyzed DFS, Division of Consumer Services, data available as of December 7, 2005, relating to Citizens' customer complaints for the 2005 storm season. As shown by **Table 7**, complaints by Citizens' customers had been reported for less than 1 percent of the claims filed. As further discussed in Finding No. 15, this apparent improvement in claims handling can be attributed to operational changes instituted by Citizens prior to the 2005 storms.

<b>Table 7</b>			
<b>Analysis of 2005 Storm Claims and Complaints</b>			
<b>Entity</b>	<b>2005 Storm Claims</b>	<b>2005 Complaints<sup>(2)</sup></b>	<b>Percent Complaints to Claims</b>
Citizens	152,596 <sup>(1)</sup>	675	0.4%

Sources:

(1) Citizens, as of December 1, 2005.  
 (2) DFS, Division of Consumer Services, as of December 7, 2005.

**Finding No. 13: Complaint Handling Procedures**

Consistent with industry practice, Citizens' agents serve as representatives of Citizens and as the link between policyholders and Citizens. As such, the agents are the focal point of contact for policyholders in the event that they have questions or complaints. However, policyholder issues sometimes arise under which a policyholder may desire to file a complaint direct with Citizens. To facilitate the receipt and timely response to policyholder complaints, Citizens should have in place a complaint handling function that is responsible for receiving, recording, and resolving complaints. We found that, although Citizens had multiple functional units involved in addressing complaints, there was no one functional unit assigned the responsibility for coordinating the receipt and ensuring the timely and effective resolution of policyholder complaints.

Absent the assignment of responsibility for the receipt, recording, and timely resolution of policyholder complaints, the concerns of policyholders may not be timely and fairly addressed. To improve its complaint handling processes, Citizens plans to establish, effective January 2006, a consolidated complaint unit that will respond to both service requests received from the DFS, Division of Consumer Services, and complaints received direct from policyholders. This unit will coordinate research and responses through the various functional areas of Citizens (for example, claims, underwriting, agency services, and policy processing) in an effort to ensure proper handling of complaints and awareness of underlying trends in policyholder service.

**Recommendation:** We recommend that Citizens continue efforts to consolidate and better coordinate its complaint handling function.

*Claims Handling*

As indicated in the Background section of this report, during the storm season of 2004, within a period of seven weeks, four hurricanes struck Florida, with some areas of the State being hit by more than one storm system. In connection with these storms, a total of 124,997 claims were submitted by, or on behalf of, Citizens’ policyholders. **Table 8** shows, for each storm, the number of claims submitted and the amounts paid pursuant to these claims, as of October 20, 2005. **Appendix B** shows, for each 2004 hurricane, the amount of claims paid in each county.

<b>Table 8</b>		
<b>2004 STORMS</b>		
<b>As of October 20, 2005</b>		
Storm Name	Number of Claims Filed	Loss Amounts Paid (In Thousands)
Hurricane Charley	21,417	\$ 492,035
Hurricane Frances	52,771	983,790
Hurricane Ivan	17,102	648,874
Hurricane Jeanne	33,707	398,385
Total	<u>124,997</u>	<u>\$ 2,523,084</u>

Source: Citizens' Claims Tracking System

During the storm season of 2005, as of September 20, 2005, a total of three major hurricanes and one tropical storm hit Florida. **Table 9** shows, for each of these storms, the number of claims submitted and the amounts paid pursuant to these claims, as of October 20, 2005.

<b>Table 9</b>		
<b>2005 STORMS</b>		
<b>As of October 20, 2005</b>		
Storm Name	Number of Claims Filed	Loss Amounts Paid (In Thousands)
Hurricane Dennis	5,980	\$ 36,185
Hurricane Katrina	24,169	77,800
Hurricane Rita	773	571
Tropical Storm Tammy	11	16
Total	<u>30,933</u>	<u>\$ 114,572</u>

Source: Citizens' Claims Tracking System

Our audit included an examination of Citizens’ claims handling procedures. We found that Citizens’ claims processing during 2005 seems to have improved over that of 2004 although the processes in place for the 2005 storms had not, during the period covered by our audit, been subjected to the same workload levels faced during the 2004 storms. Even with the improvements, we did find, as described below, some areas where further improvement was needed.

Subsequent to the completion of our claim file review, Hurricane Wilma on October 24, 2005, struck the southern part of the State. Our audit did not include a review of Citizens’ handling of Hurricane Wilma claims.

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**Finding No. 14: Monitoring of Contracted Adjuster Resources**

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Claims adjusters are responsible for evaluating evidence of loss, preparing an estimate of the loss, and calculating the amounts due to the policyholder based on the provisions of the insured's policy. The results of the adjuster's work, including the adjuster's notes and photographs of the damage, are to be recorded in a file, which is subsequently submitted for review by an examiner. Generally, following review and approval by an examiner, the amounts due to the policyholder are paid.

In order to process catastrophe claims, Citizens relies on an internal and a contracted claims adjuster and examiner force. Citizens retains internally a small force of claims adjusters and examiners to perform Citizens FastTrack<sup>4</sup> claims processing, file review, and approval. Additionally, Citizens contracts with various adjusting firms to provide a claims handling force in the event of a catastrophe.

For the 2004 hurricane season, 45 contracted adjusting firms provided adjusting services to Citizens, and as of October 20, 2005, relative to the 2005 hurricane season, 23 adjusting firms had provided adjusting services to Citizens. During the period January 1, 2004, through October 20, 2005, payments made to these contracted adjusters totaled approximately \$117 million.

The monitoring of contracted adjuster resources provides a means for determining the extent to which the services provided conform to Citizens' requirements and a basis for timely identifying performance issues that require corrective actions. To ensure that adjuster monitoring is conducted in a comprehensive and consistent manner, it is essential that reliable claims tracking systems be available and that written monitoring policies, procedures, and standards be developed and communicated to contract managers. The procedures should specify the particular processes that may be used to evaluate adjuster performance and the documentation that is to be maintained to serve as a record of monitoring efforts. Our review of Citizens' monitoring of the efforts of contracted adjusters disclosed the following deficiencies:

- At the beginning of the 2004 storm season, an effective automated system was not in place to facilitate Citizens' monitoring of the status of 2004 storm claims. A system (Claims Tracking System [CTS]) was subsequently developed by Citizens and was successfully used to track the status of 2005 storm claims and some of the claims filed during the latter part of the 2004 season. Although the CTS does allow Citizens to track the status of each claim, including the identity of the assigned adjuster and the dates of contact and actions on the claim, additional CTS capabilities would have further facilitated Citizens' ability to monitor claims and adjuster activities. For example, the CTS did not provide reports listing each of the claims assigned to a particular adjuster or adjusting firm. Additionally, the CTS did not age the claims. Such information would have been useful in making claim assignment decisions and for evaluating Citizens' exposure to performance issues.
- At the beginning of the 2004 hurricane season, Citizens had outsourced the adjusting function and did not control or monitor the activities of adjusters, although most claim files were reviewed prior to payment. Many of the claim processing delays cited in Finding No. 15 can be, at least in part, attributed to this lack of monitoring and oversight. For 2005 storms, Citizens began utilizing Team Leads, adjusters at the adjusting firms who monitor the work of other adjusters within the firm. After a catastrophe, Citizens held meetings with the Team Leads to answer questions and help provide for consistency among the adjusting firms. Notwithstanding these improvements, we found that as of the close of audit field work, Citizens had not reduced to writing the procedures to be used to monitor contracted adjusters during the course of Citizens' response to catastrophes. The availability of written procedures would better ensure a consistent and timely application of monitoring procedures.

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<sup>4</sup> For losses estimated to be relatively small, the claims were processed by telephone through Citizens Fast Track claims processing function. For these cases, a field inspection by an adjuster is not performed.

- One means for monitoring the activities of adjuster resources during the course of a response to a catastrophe is to conduct reinspections for a sample of claims for which adjusters have, within the previous two to three weeks, filed loss estimates. Such a reinspection consists of another adjuster repeating the steps appropriate to the adjustment of the claim. The timing of the reinspection allows a review of the adjuster's work, including a complete assessment of damages prior to the completion of repairs, and a timely correction of any performance problems. It is our understanding that plans are underway to initiate such reinspections. Should such reinspections be initiated, the related procedures should be reduced to writing.
- For the 2004 storms, eight adjust-your-own (AYO) firms<sup>5</sup> were authorized to approve claims up to a gross claim amount of \$100,000 without prior Citizens' claim review. Fourteen claims administrator firms<sup>6</sup> were authorized to approve claims up to a gross claim amount of \$50,000 without prior Citizens' review. Total claim payments authorized direct by AYO firms totaled approximately \$150 million, while total claims authorized direct by claims administrator firms totaled approximately \$280 million. We found that Citizens had not conducted a review focused on samples of the direct-pay claims adjusted by AYO or claims administrator firms. To reasonably ensure that these claims were processed and paid in accordance with industry standards and Citizens' requirements, Citizens should review samples of these direct-pay claims.

Without monitoring policies and procedures, Citizens lacks reasonable assurance that monitoring efforts are documented and that those efforts will be sufficiently rigorous to detect and timely correct contractor performance issues. The 2004 contracts with some of the adjuster and claims administrator firms contained performance clauses providing for a bonus or penalty of three percent of the fees paid. Had monitoring been timely performed, it may have been possible to utilize these contract clauses, as intended, to encourage superior performance, and in the case of poor performance, recoup some of the fees paid. We were provided no evidence to indicate that bonuses had been paid or penalties had been assessed.

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**Recommendation: We recommend that Citizens:**

- **Continue the development of the CTS, incorporating in the system the functionality to produce tracking reports showing the status and age of claims assigned to each adjuster and adjusting firm.**
- **Reduce its adjuster monitoring procedures to writing, including provision for:**
  - **Continuous monitoring of the status of claims, including aging of the claims, and the performance of contracted adjusters.**
  - **Reinspections of claims.**
  - **Review of samples of direct-pay claims adjusted by AYO and claims administrator firms.**

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**Finding No. 15: Catastrophe Claim Files**

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Generally, insurance claim files and related claims processing or tracking systems should include documentation that facilitates a demonstration that good faith was exercised in handling reported claims in a manner consistent with the requirements of insurance policies and governing statute and administrative rules. In addition, to allow proper financial management, the claim files and related systems should also show evidence that reserves (loss estimates) were properly established and adjusted, as necessary, to set aside moneys to cover claims. Based on industry practice, examples of documentation that should be available for each claim include:

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<sup>5</sup> For some policyholders, Citizens provides wind-only coverage. In these cases, other coverages may be provided by other insurers, and these other insurers provide adjusting services. These insurers are referred to as adjust-your-own firms.

<sup>6</sup> Claims administrator firms were engaged to provide a number of services, including file supervision, comprehensive coverage analysis, claims adjustment, management of assigned claims, establishment and adjustment of claim reserves, and the settlement of claims.

- From the adjuster, notes, photographs of damages, estimates of the property's replacement value and the cost of repairs or replacements, and a calculation of the amounts due to the policyholder.
- Evidence that an examiner of the insurer has reviewed the claim, obtained clarifications, and made corrections as necessary.
- When requested by the insurer, a proof of loss executed by the insured to describe the cause and extent of damages sustained.
- A clear trail of correspondence and notes on insurer actions, including the dates thereof, that allow a demonstration that the insurer has, in handling the claim, conformed to insurance policy requirements and industry standards and acted in good faith to settle the insured's claim.
- Evidence that a reserve has been established in an amount consistent with the most recent estimate of the damages incurred.

We examined 219 claim files, including for the 2004 storms, 160 claims, pursuant to which a total of approximately \$320 million was paid, and for the 2005 storms, 59 claims, pursuant to which approximately \$220,000 had been paid as of October 20, 2005. With respect to each of these claims, we determined the timeliness with which the claims were processed, the extent to which file evidence supported the existence of a loss, the extent to which the described and depicted losses were consistent with the amounts paid, the sufficiency of case reserves, the sufficiency of the steps taken by Citizens to review the findings of the contracted adjusters, and the reasonableness of the fees paid to contracted adjusters. Our audit did not include reinspection of the properties. To assist us in the review of these files, we retained the services of an insurance industry consultant.

Specifically, the review of claim files and claim adjustment procedures disclosed the following:

- Insurance industry standards and State law require that insurers exercise good faith in the handling of claims. One aspect of the exercise of good faith is the timely processing of policyholder claims. With respect to our evaluation of the timeliness of claims processing, we found that many documents in the 2004 and 2005 claim files were not dated. In these instances, it was not possible for Citizens to demonstrate, or practicable for us to measure, the extent to which Citizens had timely processed these claims. Notwithstanding the absence of dates, we were able to determine that for the 2004 storms, as shown below in **Table 10**, there was often a significant lag between the filing of a claim and the assignment of the claim to an adjuster. Also, **Table 11** shows significant delays in closing the 2004 storm claims. Contributing to these delays was an initial shortage of adjuster resources and Citizens' failure to adequately monitor the progress of the processing of claims.

With respect to the 2005 storm claims reviewed, we found that the claims were processed more expeditiously, as shown in **Tables 10** and **11**. As shown in **Table 11**, the percentage of claims completed within 60 days of the initial filing increased from 32 percent in 2004 to 79 percent in 2005.

Table 10 Days Between Claim Filing and Adjuster Assignment				
Number of Days	2004 Storms		2005 Storms	
	Number of Claims	Percentage of Claims	Number of Claims	Percentage of Claims
0 to 5	49	31%	30	51%
6 to 14	13	8%	4	7%
15 to 28	7	4%	5	8%
29 and over	24	15%	2	3%
Unable to Determine	<u>67</u>	42%	<u>18</u>	31%
Total	<u>160</u>		<u>59</u>	

Source: Citizens' Claims Tracking System

Table 11 Days Between Claim Filing and Claim Closing				
Number of Days	2004 Storms		2005 Storms	
	Number of Claims	Percentage of Claims	Number of Claims	Percentage of Claims
0 to 30	8	5%	27	45%
31 to 60	43	27%	20	34%
61 to 90	20	12%	1	2%
91 to 180	29	18%	1	2%
181 and Over	38	24%	0	0%
Open or Unable to Determine	<u>22</u>	14%	<u>10</u>	17%
Total	<u>160</u>		<u>59</u>	

Source: Citizens' Claims Tracking System

- The fees paid by Citizens to contracted adjusters and claims administrators were sometimes high in relation to the services received. Contributing to this conclusion were:
  - The field adjuster was, pursuant to Citizens' payment schedule, paid a fee of one percent of the gross claim amount. For those claims assigned to a claims administrator firm (often the employer of the adjuster), the firm was paid for the same claim a fee of one percent of the net claim amount (gross claim amount reduced by the deductible and the amount of recoverable depreciation<sup>7</sup>), although in some instances, this fee was as high as 3.3 percent of the net claim amount. By contract, the claims administrator firms were to provide a number of services, including file supervision, comprehensive coverage analysis, superior adjustment, management of assigned claims, timely establishment and adjustment of claim reserves, and the settlement of claims. As a result of the deficiencies found in the files examined, the files did not always indicate that the claims administration fees paid had actually been earned. Several instances were noted in which the files initially submitted had included damages, such as those covered by flood insurance, not covered by the insured's policy. These errors were corrected by Citizens' examiners prior to payment of the claims.
  - Prior to the disbursement of amounts held for recoverable depreciation, a reinspection by an adjuster was required. Upon the adjuster's reinspection of the property after repair, an additional fee was paid to the adjuster. We found that, rather than calculating the fee based on, for example, the adjuster's actual documented time and expense, the adjuster was paid an additional 1 percent of the amount of recoverable depreciation.

<sup>7</sup> Recoverable depreciation is the amount the insurer withholds from the claim payment until the insured demonstrates that repairs have been completed. Effective October 1, 2005, Section 627.7011, Florida Statutes, precludes insurers from withholding recoverable depreciation.



- Although Citizens' adjuster fee schedule contains a provision authorizing a change from the percentage-based fee to a fee based on actual adjuster time and expense, we found no evidence in the files reviewed to indicate that the time and expense option had been exercised by Citizens. Current industry practice is to use time and expense-based adjuster fees when damages exceed a certain dollar threshold, for example \$500,000. Had the time and expense option been exercised for large dollar claims, savings may have been realized.
- On November 5, 2004, Citizens' claims management issued Bulletin #14, entitled "Insurance to Value (ITV) and Coinsurance," which instructed claims administrators, AYO companies, and examiners not to complete an insurance-to-value analysis for 2004 storms, except in the case of a total loss. Consistent with the Bulletin's requirements, we found few insurance-to-value analyses in the files reviewed. An insurance-to-value analysis facilitates a determination as to whether the property was insured at a level commensurate with the replacement cost of the property. Should the analysis show that a property's insured value, as shown by the policy, is less than 80 percent of the property's estimated replacement cost, Citizens then, pursuant to policy loss settlement provisions, may become responsible for a smaller portion of the claim. In explanation, Citizens' management stated that because Citizens did not have a consistent valuation methodology available to agents and insureds to help them establish a replacement cost amount, nor an adopted valuation benchmark, it was unfair to impose a coinsurance penalty.
- In areas impacted by a storm, Citizens establishes for each insured property in that area a case reserve, or estimated liability, in an amount determined based upon the severity of the storm. Following field adjuster review of the damages, the case reserve is to be updated to reflect the best and most recent estimate of the claim payment that will be due. As indicated by the following, we found that case reserves were not always properly maintained:
  - Citizens' reserving philosophy requires that the initial case reserve be established in the same amount for both commercial claims and residential claims. For example, the initial case reserve established in connection with a storm of moderate severity may be \$10,000. Under Citizens' reserving philosophy, a \$10,000 reserve would have been established for a residential property, and a \$10,000 reserve would have been established for a commercial property, such as a condominium facility. As the amounts paid pursuant to commercial claims are often more than that paid for residential claims, it was not clear that Citizens' case reserve approach provided, for commercial properties, a best initial estimate of loss.
  - Case reserves were to be updated following field adjuster evaluation of the loss. In many instances, we found that the amounts paid in settlement of claims exceeded the case reserve, indicating that the reserve amounts had not been appropriately updated to show the best and most recent estimate of the amount of the claim payment.
  - Citizens' systems did not allow the recording of a reserve in excess of \$9,999,999. This limit may have resulted in the significant understatement of the loss reserve for some commercial properties. Included in our sample of claims were several commercial claim payments well in excess of \$9,999,999.
  - The amounts reserved for claims did not include an estimate for the amount of recoverable depreciation that had not been paid to the policyholder. For some commercial claims, this amount could have been substantial.

To the extent that claims remain open at year-end, the reserves provide one of the bases considered in setting the insurer's estimate of its liability for incurred but unpaid losses. Deficiencies in the maintenance of the reserves could, absent appropriate compensating actuarial calculations, adversely impact the fairness of the amount reported by Citizens as its liability for unpaid claims.

- For two claims, it did not appear that the correct amount had been paid in settlement of the claim. For a third claim, the file lacked sufficient information to allow a complete evaluation of the amounts paid. Information relating to these claims has been provided for further review by Citizens' claims management.

**Recommendation:** We recommend that Citizens:

- Exercise greater care to ensure that its records contain complete claim files.
- Continue efforts, evident thus far for the 2005 claims, to timely process and pay the amounts due as a result of policyholder losses.
- Reconsider the fee structure used in the payment of contracted adjusters.
- Adopt and enforce the usage of a standard methodology for establishing the insurable value of properties.
- In the future, complete insurance-to-value analyses for each claim and, where applicable, include coinsurance penalties in the calculation of the amounts due to policyholders.
- Consider the establishment of larger initial reserve amounts for commercial claims, timely update the initial reserve amounts to ensure that they reflect the most recent estimate of the amounts due to the policyholder, and modify its systems to eliminate the reserve limit of \$9,999,999.

**Follow-up to Management Response:**

*In response to this finding, Citizens indicated that, for 2004 storm claims, it had deemed it unnecessary to require an insurance-to-value (ITV) analysis on each catastrophe claim file and indicated that this action was appropriate for various reasons. The point of our comment was to disclose that, with respect to Citizens' claims, a standard industry practice had not been followed and the standard industry practice was not followed because of management concerns with respect to the absence of a consistent methodology for the valuation of insured properties. As indicated in our recommendation for this finding, steps should be taken to ensure the proper valuation of property and ITV analyses should be performed for future claims.*

**Premiums**

For the years ended December 31, 2003, and 2004, premium revenues totaled more than \$1 billion. Citizens' annualized premiums by account for the years ended December 31, 2003, 2004, and 2005 (through September 30, 2005), are shown in **Table 12**.

Table 12 Premiums 2003 Through 2005			
Accounts	Gross Annualized Premiums (In Millions)		
	Year Ended December 31,		
	2003	2004	2005
High Risk Account (HRA)	\$571	\$690	\$792
Personal Lines Account and Commercial Lines Account (PLA/CLA)	\$533	\$545	\$498
Source: Citizens' Exposure and Premium Reports			

In general, the premium due from a Citizens' policyholder is derived by multiplying the insured value of the property by a premium rate. The premium rates charged by Citizens must be approved by the Office of Insurance Regulation and are governed by the following provisions of Section 627.351(6)(d), Florida Statutes:

- Pursuant to Section 627.351(6)(d)1., Florida Statutes, "It is the intent of the Legislature that the rates for coverage provided by the corporation be actuarially sound and not competitive with approved rates charged in

the admitted voluntary market, so that the corporation functions as a residual market mechanism to provide insurance only when the insurance cannot be procured in the voluntary market.”

- As a mechanism for ensuring that Citizens’ rates are not competitive with those of the voluntary market, Section 627.351(6)(d)2., Florida Statutes, provides that rates shall be “no lower than the average rates charged by the insurer that had the highest average rate in that county among the 20 insurers with the greatest total direct written premium in the state for that line of business in the preceding year, except that with respect to mobile home coverages, the average rates of the corporation shall be no lower than the average rates charged by the insurer that had the highest average rate in that county among the 5 insurers with the greatest total written premium for mobile home owner’s policies in the state in the preceding year.” The statute requires that this rate floor be applied to personal lines residential properties (policies in the PLA account), excluding Wind-Only policies.
- Section 627.351(6)(d)3., Florida Statutes (2005), provides that the rates for personal lines residential Wind-Only policies (policies in the HRA account) must be actuarially sound and not competitive with approved rates charged by other insurers. Prior to 2005, Section 627.351(6)(d)3., Florida Statutes (2004), provided caps in premium rate increases for the Wind-Only policies.

**Table 13** summarizes by account the statutory provisions governing Citizens’ premium rates.

<b>Table 13 Statutory Rate Criteria 2002 Through 2005</b>									
Criteria	July 1, 2002, through June 30, 2003			July 1, 2003, through June 30, 2004			July 1, 2004, through June 30, 2005		
	PLA	HRA	Commercial	PLA	HRA	Commercial	PLA	HRA	Commercial
Must be Noncompetitive	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Must be Actuarially Sound	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Increases Capped	No	10 % <sup>(1)</sup>	No	No	20 % <sup>(1)</sup>	No	No	No	No

Note: (1) Section 627.351(6)(d)6., Florida Statutes, states, "Nothing in this paragraph shall require or allow the corporation to adopt a rate that is inadequate under s. 627.062." Section 627.062(1), Florida Statutes, requires that rates not be excessive, inadequate, or unfairly discriminatory.

**Finding No. 16: Actuarial Soundness of Rates**

As indicated by **Table 13**, the premium rates assessed by Citizens for all accounts are to be actuarially sound. To establish the actuarial soundness of the rates, actuarial studies are necessary. The actuarial studies, through statistical processes, estimate for the year to be covered by the account premiums, Citizens’ losses and operating expenses and the premiums that would be required to cover those losses and expenses. The estimate of the losses and expenses of Citizens would be based on a variety of factors unique to Citizens, such as its loss experience and its loss exposure based on the geographic location and concentration of the properties covered by its policies.

Our audit disclosed that the rates in effect through June 30, 2005, were based on the premium rates approved for the top 20 insurers or top 5 insurers, as applicable. However, actuarial studies were not available to demonstrate the extent to which the rates assessed were, as required by Section 627.351(6)(d)1., Florida Statutes, actuarially sound. In response to our inquiries, Citizens and the OIR have indicated that since the rates of the top 20 or top 5 insurers, as applicable, were actuarially sound, then Citizens’ rates, if based thereon, would also be actuarially sound. As the actuarial calculation of rates is based on a variety of factors unique to each insurer, and especially unique to Citizens as an insurer of last resort, it was not clear how the rate setting methodology used assured the actuarial soundness of Citizens’ rates.

**Recommendation:** To allow a demonstration that rates are both noncompetitive with the voluntary market and actuarially sound, we recommend that Citizens provide actuarial studies in support of all future rates.

***Probable Maximum Loss Financing***

Consistent with Florida insurance industry practice, Citizens is responsible for ensuring that sufficient liquid resources exist to pay no less than the probable maximum loss (PML) associated with a 1-in-100 year storm (100-year PML).<sup>8</sup> In meeting this responsibility, Citizens utilizes modeling to predict a worst case scenario storm and the resulting losses that would be incurred by Citizens, given its policy commitments. These modeling processes yield two 100-year PMLs, one for the risks accounted for within the personal lines and commercial lines accounts (PLA/CLA), and one for the risks accounted for within the High Risk Account (HRA). **Table 14** shows at June 2002, 2003, and 2004, the estimated 100-year PMLs by account.<sup>9</sup>

<b>Table 14 PML Analysis June 2002 Through June 2004</b>			
<b>PLA/CLA Accounts</b>		<b>HRA Account</b>	
<b>Date</b>	<b>100-Year PML (In Billions)</b>	<b>Date</b>	<b>100-Year PML (In Billions)</b>
June 2002	\$2.300	June 2002	\$4.861
June 2003	\$2.200	June 2003	\$7.148
June 2004	\$2.000	June 2004	\$7.200

To fund the payment of the 100-year PMLs, Section 627.351(6), Florida Statutes, authorizes Citizens to secure the necessary resources from the following sources:

- Available cash on hand from operations (surplus).
- Proceeds from assessments, including market equalization surcharges on Citizens’ policies.
- Private market reinsurance.
- Reinsurance from the Florida Hurricane Catastrophe Fund (FHCF).
- Borrowed funds, such as, lines of credit and bond issues.

To illustrate the financing available to Citizens, we obtained from Citizens the resource plans in place for the 2004 storm season, as of the June 2004 PML estimates. For the June 2004 projections, **Chart 1** shows Citizens’ depiction of the resources available to cover the \$2 billion PLA/CLA 100-year PML, and **Chart 2** shows Citizens’ depiction of the resources available for the \$7.2 billion HRA 100-year PML.

<sup>8</sup> A 1-in-100 year storm is defined as a storm having a 1 percent (1/100) chance of occurrence in any year.

<sup>9</sup> As of November 2005, Citizens’ estimates of the 100-year PMLs for the PLA/CLA and HRA accounts were \$2.14 billion and \$7.6 billion, respectively.

Chart 1 June 2004 100-Year PLA/CLA PML Resource Plan			
	Billions	Amount Available	Type Financing
<div style="border: 1px solid black; background-color: blue; color: white; padding: 5px; text-align: center;"> <b>100 Year PML = \$2 Billion</b> </div>	\$3.325	\$100 million	1997 Pre-Event Bonds
	\$3.225	\$1.5 billion	Regular Assessments
	\$1.725	\$1 billion* [FHCF Attachment Point \$300 million]	Florida Hurricane Catastrophe Fund Reinsurance
	\$0.725	\$725 million	Surplus
			* Citizens' estimate

Source: Citizens' 6/1/2004 Claims Paying Resource Chart

Chart 2 June 2004 100-Year HRA PML Resource Plan			
	Billions	Amount Available	Type Financing
<div style="border: 1px solid black; background-color: blue; color: white; padding: 5px; text-align: center;"> <b>100 Year PML = \$7.2 Billion</b> </div>	\$7.200	\$750 million	2004 Pre-Event Bonds
	\$6.450	\$1 billion	1999A Pre-Event Bonds
	\$5.450	\$300 million	1997A Pre-Event Bonds
	\$5.150	\$3.3 billion* [FHCF Attachment Point \$1.1 billion]	Florida Hurricane Catastrophe Fund Reinsurance
	\$1.850	\$750 million	Regular Assessments
	\$1.100	\$1.1 billion	Surplus
			* Citizens' estimate

Source: Citizens' 6/1/2004 Claims Paying Resource Chart

These charts are presented only as a means of illustrating the financing options available to Citizens in the event of a 1-in-100 year storm. The charts provide estimated resource amounts and do not purport to provide an actual accounting of Citizens' moneys or show the order in which the resources would be available or used. A more complete explanation of each type of resource available to Citizens is shown by [Appendix C](#).

**Finding No. 17: Financing Options**

Our evaluation of the reasonableness of the approach used by Citizens to provide 100-year PML financing included a review of laws governing Citizens' finances; surveys of literature addressing catastrophe financing by insurers; interviews of current and former Citizens' personnel, financial advisors employed by Citizens, and personnel of the State Division of Bond Finance; and reviews of selected Citizens' records, including loan and bond documents, minutes of the Board of Governors meetings, Citizens' financial statements, and reports of other auditors. In general, we found the financing approach used by Citizens to be reasonable, although we did find some areas in which enhancements may be possible. Specifically:

➤ As shown by **Charts 1** and **2**, resources made available to pay 100-year PMLs have included the proceeds of pre-event bonds (bonds issued in anticipation of storm events). In using such financing, a primary goal must be the maintenance of the safety and liquidity of the proceeds through conservative investment. There is also, however, a need to minimize the cost of carrying the debt (cost-of-carry). The cost-of-carry is defined as the difference between the interest expense accruing on the debt and the investment earnings accruing on the proceeds while they are available for investment. The cost-of-carry can be minimized over the life of the debt by initially structuring the debt issue such that the interest rate on the debt issued is matched as closely as possible to expected rates of return on conservatively invested proceeds. We found that Citizens has been successful in minimizing the cost-of-carry of the Series 2004A Auction Rate Securities, issued in May 2004. The interest rate on these bonds is variable and tied to short-term rates, making it feasible to match the interest expense of the bonds with the earnings that can be derived using a conservative investment strategy. However, in the case of the pre-event bonds issued by Citizens' predecessor organizations, the Florida Residential Property and Casualty Joint Underwriting Association (FRPCJUA) and the Florida Windstorm Underwriting Association (FWUA), the interest expense paid on the bonds has significantly exceeded the amounts earned on the proceeds. Because these bonds were structured with a fixed interest rate (ranging from 6.50 to 7.625 percent) that in recent years has resulted in interest expense in excess of the interest earnings that could be obtained on the invested proceeds, we estimate as shown in **Table 15**, that the total interest expense paid through December 31, 2004, has exceeded by more than \$230 million the amounts earned by investing the bond proceeds. This cost-of-carry has grown to more than \$277 million as of September 30, 2005, and has contributed significantly to decreases in Citizens' surplus.

<b>Table 15</b> <b>Comparison of Bond Interest Expense</b> <b>and Earnings on Investment of Bond Proceeds</b> <b>Series 1997 PLA, 1997A HRA, and 1999A HRA</b> <b>From Bond Issuance Through December 31, 2004</b> <b>(In Millions)</b>			
Bond Series	Interest Earnings <sup>(1)</sup>	Interest Expense	Earnings Positive (Negative)
1997 PLA	\$ 175	\$ 242	\$ (67)
1997A HRA	261	318	(57)
1999A HRA	304	410	(106)
Total	<u>\$ 740</u>	<u>\$ 970</u>	<u>\$ (230)</u>

Note: (1) Earnings were calculated based on semi-annual rates of return for each applicable six-month interest payment period and include realized gains on swap agreements terminated prior to 2002.

Citizens has engaged financial advisors over the past several years to propose solutions for these bond issues. Matters that have been given consideration have included various forms of hedging techniques, such as interest rate swaps,<sup>10</sup> and refinancing (refunding), at more advantageous terms, the bonds that are not nearing maturity (that is, the Series 1999A HRA issue). Citizens has not identified hedging opportunities that it considers satisfactory, and the early redemption (call) provisions of the Series 1999A bonds have made a refunding of that bond issue problematic.

The Series 1999A call provisions require the payment of a premium based on the Treasury rate of interest plus 30 basis points. If the Treasury rate of interest is less than 6.825 percent, a premium payment is required. The

<sup>10</sup> An interest rate swap is a contract under which one debtor agrees to exchange interest payment obligations with another debtor (for example, exchange fixed interest payment obligations for variable rate interest payment obligations). In seeking such arrangements, Citizens would seek variable interest payment obligations with payment streams approximating those of the estimated earnings on the related debt proceeds.

lower the Treasury rates of interest, the higher the call premium. A refunding, should it have been executed in September 2004, would, for example, have required the payment of a call premium of approximately \$245 million.

We requested from Citizens documentation that might explain the basis for the structuring of the FWUA Series 1999A HRA bond issue. In response to our inquiries, we were informed that the executive staff, legal advisors, and financial advisors who would be knowledgeable concerning the structuring of this bond issue are no longer associated with Citizens, and documentation supporting bond structure decisions, other than the legal opinions contained in the bond documents, were not available.

- Findings included in our report have indicated that there may be opportunities to increase the amount of surplus provided by operations. For example:
  - Finding No. 16 discloses that Citizens cannot demonstrate the extent to which the premiums charged over the last several years were actuarially sound. The collection of actuarially sound premiums may increase premiums and surplus.
  - Finding No. 15 discloses some opportunities for reducing catastrophe loss adjustment expenses. Such reductions in expense would increase surplus.
  - Finding No. 6 discloses that competitive methods have not been used extensively in selecting service providers. The use of competition in the award of these contracts may result in more favorable pricing, which would result in reduced expenses and increased surplus.

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**Recommendation: We recommend that Citizens:**

- **For the FWUA Series 1999A bonds, continue the exploration of means by which the differential between interest expense and investment earnings may be reduced. In July 2005, a new financial advisor was retained to assist the Board as it continued to pursue prudent solutions specifically for the 1999A HRA bonds. A hedging proposal has been a primary focus of the work.**
- **As also addressed in other findings of this report, maximize available surplus by assessing and collecting all premiums due under the authority of law; reducing, where possible, loss adjustment expenses; and engaging service providers through competitive means.**

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***Other Matters***

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A former employee of Citizens is currently the subject of an ongoing criminal investigation. The outcome of this investigation and its implications, if any, relative to the controls or operations of Citizens was unknown as of the close of our audit field work.

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**OBJECTIVES, SCOPE, AND METHODOLOGY**

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This operational audit focused on selected areas of operation designated by Section 26 of Chapter 2005-111, Laws of Florida. As required, the scope of our audit included an analysis of Citizens' infrastructure, customer service, claims handling, the accessibility of policyholder information to the agent of record, take-out programs, take-out bonuses, and financing arrangements. Also, as required, the scope of the audit included an evaluation of costs associated with the administration and servicing of Citizens' policies to determine alternatives by which costs can be reduced, customer service can be improved, and claims handling improved.

Further, in accordance with an October 19, 2005, letter from the President of the Senate, the scope of the audit included an evaluation of Citizens' standards of conduct and ethical requirements for employees and Board members, hiring practices, background screenings, compensation for employees and consultants, and Board oversight and internal controls over procurement practices.

Relative to the areas included within the scope of audit, our audit objectives were:

- To determine the extent to which Citizens' controls promote and encourage the achievement of management's control objectives in the categories of compliance with controlling laws, contracts, insurance industry practice, and other guidelines; the efficient operation of Citizens; the reliability of records and reports; and the safeguarding of assets.
- To evaluate management's performance in achieving compliance with controlling laws, contracts, insurance industry practice, and other guidelines; the economic, efficient, and effective operation of State government; the reliability of records and reports; and the safeguarding of assets.
- To identify statutory and fiscal changes that may be recommended to the Legislature pursuant to Section 11.45(7)(h), Florida Statutes.

The methodology for this audit included:

- Obtaining an understanding of governing laws, guidelines, and industry practice in selected areas.
- Testing the effectiveness of internal controls relevant to the scope of the audit.
- Interviews of Citizens' management and staff, Office of Insurance Regulation personnel, Department of Financial Services personnel, insurance professionals, financial advisors engaged by Citizens, Florida Division of Bond Finance personnel, legislative staff, and personnel of last resort insurers of other states.
- Surveys of agents and policyholders.
- Analytical evaluations and tests of data files and other records provided by Citizens, the Office of Insurance Regulation, and the Department of Financial Services.
- With the help of a specialist, evaluations of catastrophe claims handling procedures and, for a selection of claims, catastrophe claim file documentation.



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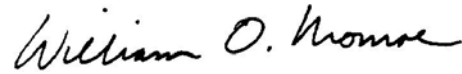
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**AUTHORITY**

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Pursuant to the provisions of Section 11.45, Florida Statutes, and Section 26 of Chapter 2005-111, Laws of Florida, I have directed that this report be prepared to present the results of our operational audit.



William O. Monroe, CPA  
Auditor General

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**MANAGEMENT RESPONSES**

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As required by law, our preliminary and tentative audit findings were provided to the President and Executive Director of Citizens Property Insurance Corporation and the Commissioner of the Office of Insurance Regulation. In letters dated January 23, 2006, they provided responses to our findings and recommendations. The responses may be viewed in their entirety at the end of this report as **Appendix D**.

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APPENDIX LIST

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*APPENDIX A - SUMMARY BY COUNTY OF NEW POLICIES WRITTEN*

*APPENDIX B - CLAIMS PAID BY COUNTY FOR 2004 HURRICANES*

*APPENDIX C - FINANCIAL RESOURCES, JUNE 2004 100-YEAR PMLS*

*APPENDIX D - MANAGEMENT RESPONSES*

**APPENDIX A**  
**CITIZENS PROPERTY INSURANCE CORPORATION**  
**SUMMARY BY COUNTY OF NEW POLICIES WRITTEN**  
**QUARTER ENDED DECEMBER 31, 2004**

COUNTY	PERSONAL RESIDENTIAL			COMMERCIAL RESIDENTIAL		
	Number of Voluntary Insurers Writing New Policies	Number of New Policies Written by Voluntary Insurers	Number of Policies Written by Citizens <sup>(1)</sup>	Number of Voluntary Insurers Writing New Policies	Number of New Policies Written by Voluntary Insurers	Number of Policies Written by Citizens <sup>(1)</sup>
Alachua	67	2,672	239	4	10	1
Baker	34	255	6	-	-	-
Bay	58	2,953	465	7	23	18
Bradford	34	258	21	-	-	-
Brevard	72	8,481	1,451	9	29	24
Broward	77	24,057	14,186	12	167	275
Calhoun	24	134	9	1	1	-
Charlotte	65	3,130	721	7	12	-
Citrus	64	2,365	534	4	14	-
Clay	62	2,746	116	4	7	-
Collier	77	7,461	984	9	151	7
Columbia	42	790	41	2	3	-
DeSoto	33	483	55	1	1	-
Dixie	34	166	43	-	-	-
Duval	81	12,391	1,203	9	29	10
Escambia	59	4,220	711	4	8	4
Flagler	65	2,385	191	2	2	2
Franklin	31	208	140	-	-	-
Gadsden	42	438	40	-	-	-
Gilchrist	31	203	31	-	-	-
Glades	17	107	9	2	2	-
Gulf	40	272	115	1	1	1
Hamilton	19	155	9	-	-	-
Hardee	29	224	5	-	-	-
Hendry	30	357	27	-	-	1
Hernando	53	2,379	1,508	1	1	-
Highlands	63	1,546	115	1	1	-
Hillsborough	84	16,895	6,445	14	52	10
Holmes	33	211	6	-	-	-
Indian River	64	2,000	346	5	10	5
Jackson	39	463	24	1	1	-
Jefferson	31	184	14	-	-	-
Lafayette	19	50	15	-	-	-
Lake	82	5,772	348	4	12	-
Lee	85	12,722	2,507	10	91	9
Leon	66	3,138	210	6	11	10
Levy	44	469	112	-	-	1
Liberty	21	56	6	-	-	-
Madison	28	220	16	-	-	-
Manatee	75	6,697	1,267	14	31	18
Marion	77	5,676	370	5	10	1
Martin	67	2,246	259	6	16	-
Miami-Dade	72	20,846	24,928	16	390	348
Monroe	35	1,646	1,245	5	10	21
Nassau	59	1,167	138	-	-	3
Okaloosa	58	3,423	232	3	3	8
Okeechobee	36	479	51	-	-	-
Orange	87	17,671	1,112	12	26	3
Osceola	70	5,316	238	6	10	1
Palm Beach	90	21,609	8,423	13	79	103
Pasco	68	6,871	5,559	6	13	6
Pinellas	79	9,072	9,489	13	106	59
Polk	80	9,206	755	9	21	1
Putnam	47	825	94	2	2	-
St. Johns	69	4,239	353	5	12	7
St. Lucie	66	5,915	705	6	15	9
Santa Rosa	59	2,487	228	2	8	1
Sarasota	76	9,611	3,097	11	36	27
Seminole	80	6,369	364	5	7	-
Sumter	54	1,291	74	-	-	-
Suwannee	38	479	24	-	-	-
Taylor	30	177	91	-	-	1
Union	18	82	6	-	-	-
Volusia	86	7,963	1,796	10	23	28
Wakulla	43	441	63	-	-	-
Walton	56	1,155	600	2	2	7
Washington	33	205	17	1	1	-
<b>Totals</b>	<b>3,607</b>	<b>276,180</b>	<b>94,602</b>	<b>272</b>	<b>1,460</b>	<b>1,030</b>

Note: (1) Approximately 23,000 of the Citizens' policies were Wind-Only policies.  
 Source: Office of Insurance Regulation's Quarterly Supplemental Report.

**APPENDIX B**  
**CITIZENS PROPERTY INSURANCE CORPORATION**  
**CLAIMS PAID BY COUNTY FOR 2004 HURRICANES**  
**AMOUNTS IN (000's)**

County	Charley	Frances	Ivan	Jeanne	Total
Alachua	\$ 9	\$ 610	\$ 9	\$ 145	\$ 773
Baker	-	-	-	-	-
Bay	2	95	26,151	227	26,475
Bradford	3	53	6	23	85
Brevard	725	185,274	373	50,531	236,903
Broward	1,246	20,117	455	5,730	27,548
Calhoun	-	-	223	-	223
Charlotte	88,124	528	38	454	89,144
Citrus	16	1,041	24	633	1,714
Clay	-	160	-	44	204
Collier	3,102	345	28	194	3,669
Columbia	-	26	6	53	85
DeSoto	5,071	121	-	70	5,262
Dixie	-	76	-	90	166
Duval	248	2,398	9	560	3,215
Escambia	26	2,951	448,163	3,749	454,889
Flagler	1,777	4,569	150	630	7,126
Franklin	5	15	165	11	196
Gadsden	-	4	2	-	6
Gilchrist	-	42	-	19	61
Glades	3	120	-	87	210
Gulf	-	4	259	21	284
Hamilton	-	-	-	16	16
Hardee	595	67	19	48	729
Hendry	10	124	27	84	245
Hernando	52	5,075	156	2,268	7,551
Highlands	808	204	16	1,249	2,277
Hillsborough	170	4,919	145	6,894	12,128
Holmes	-	-	33	-	33
Indian River	132	156,161	355	73,054	229,702
Jackson	-	17	85	2	104
Jefferson	-	1	-	6	7
Lafayette	-	-	-	-	-
Lake	14	1,056	4	1,244	2,318
Lee	325,541	2,687	407	421	329,056
Leon	-	1	-	5	6
Levy	-	136	7	56	199
Liberty	-	-	3	-	3
Madison	-	27	-	28	55
Manatee	93	733	40	1,674	2,540
Marion	1	618	13	612	1,244
Martin	29	22,632	20	7,950	30,631
Miami-Dade	881	25,061	676	6,316	32,934
Monroe	124	200	5	16	345
Nassau	-	910	1	509	1,420
Okaloosa	-	146	52,607	540	53,293
Okeechobee	17	1,841	-	875	2,733
Orange	11,884	3,943	58	4,660	20,545
Osceola	3,571	769	-	1,258	5,598
Palm Beach	954	316,278	2,893	147,614	467,739
Pasco	285	15,979	252	16,501	33,017
Pinellas	330	13,945	312	18,198	32,785
Polk	5,585	2,193	2	6,400	14,180
Putnam	1	212	15	145	373
St. Johns	272	25,177	79	935	26,463
St. Lucie	142	81,858	654	19,230	101,884
Santa Rosa	7	840	88,403	472	89,722
Sarasota	983	1,805	16	2,949	5,753
Seminole	1,927	1,171	40	1,482	4,620
Sumter	-	111	2	243	356
Suwannee	-	15	-	21	36
Taylor	-	25	-	32	57
Union	-	-	-	5	5
Volusia	37,270	78,088	586	10,812	126,756
Wakulla	-	-	24	25	49
Walton	-	216	24,820	265	25,301
Washington	-	-	38	-	38
<b>Total</b>	<b>\$ 492,035</b>	<b>\$ 983,790</b>	<b>\$ 648,874</b>	<b>\$ 398,385</b>	<b>\$ 2,523,084</b>

Source: Amounts based on October 20, 2005, data file provided by Citizens Property Insurance Corporation.

*APPENDIX C*  
*CITIZENS PROPERTY INSURANCE CORPORATION*  
*FINANCIAL RESOURCES,*  
*JUNE 2004 100-YEAR PMLs*

***Regular Assessments and Market Equalization Surcharge***

Pursuant to Section 627.351(6)(b)3., Florida Statutes, and Section 16 of Citizens' Plan of Operation, assessments may be levied to recover deficits incurred in a given plan year by account. Deficits are to be determined in accordance with accounting principles generally accepted in the United States (GAAP) adjusted for certain items. Deficits are calculated separately and assessments are levied separately for each of Citizens' three accounts, those being the Personal Lines Account (PLA), Commercial Lines Account (CLA), and the High-Risk Account (HRA).

Regular assessments are levied by Citizens upon all assessable insurers and assessable insureds. (Assessable insureds are those insureds which procure one or more surplus lines of business in this State pursuant to Chapter 626, Part VIII, Florida Statutes.) For any year in which a deficit occurs, a regular assessment is to be levied in an amount equal to the greater of (i) 10 percent of the prior year's Statewide direct written premiums for property insurance for all assessable insurers and assessable insureds, or (ii) 10 percent of the deficit. The amount of regular assessments levied, however, is not to exceed the amount of the deficit.

Assessable insurers are liable for regular assessments imposed by Citizens based upon the insurer's share of direct written premiums for the subject lines of business in the State for the calendar year preceding the year in which the deficit occurred, as reduced for any voluntary writings for that year. Assessable insureds are liable for regular assessments imposed by Citizens based upon the insureds' share of direct written premiums for the subject lines of business in the State for the calendar year preceding the year in which the deficit occurred.

Citizens also assesses its policyholders a market equalization surcharge upon the levy of a regular assessment. The surcharge is assessed in a percentage equal to that assessed to the assessable insurers and assessable insureds.

The adjusted GAAP deficit as of December 31, 2004, was \$515,489,000 for the HRA account, which was to be fully funded with regular assessments. An assessment, in accordance with Section 16 of Citizens' Plan of Operation, was verified and approved by the Office of Insurance Regulation on August 26, 2005.

***Private Reinsurance***

Section 627.351(6)(c)9., Florida Statutes, authorizes Citizens to purchase reinsurance from the private market. Under such an agreement, Citizens could cede (transfer) a part of its risk of loss under insurance policies to another insurance company, referred to as a reinsurer, in return for a percentage of the written premium. For the 2004 hurricane season, Citizens did not obtain reinsurance because the costs of private reinsurance were considered by Citizens to be too high in relation to the risks of loss transferred.

***Florida Hurricane Catastrophe Fund***

Citizens participates in the Florida Hurricane Catastrophe Fund (FHCF), established by Section 215.555(3), Florida Statutes. The FHCF reimburses Citizens for 90 percent of the aggregate amount of ultimate loss paid by Citizens, up to the coverage amount per account in excess of Citizens' aggregate attachment point for each account. For the year ended December 31, 2004, the premiums paid to the FHCF totaled approximately \$177 million.

*APPENDIX C (CONTINUED)*

***Lines of Credit***

Citizens may negotiate lines of credit to provide liquidity should there be delays in the availability of other resources. At December 31, 2004, Citizens had no outstanding lines of credit with lending institutions.

***Bonds***

Section 627.351(6)(c)3., Florida Statutes, authorizes Citizens to issue bonds. The bonds may be issued in anticipation of (pre-event bonds) or subsequent to (post-event bonds) the need for payment of catastrophe claims. Pre-event bonds, under Federal regulations, are subject to Federal taxation. Post-event bonds would likely not be subject to Federal taxation. As of December 31, 2004, Citizens had not issued post-event bonds. As of December 31, 2004, the following pre-event bonds were outstanding:

<b>Bond Description</b>	<b>Amount (In Millions)</b>
<b>PLA/CLA Account</b>	
FRPCJUA <sup>(1)</sup> , Series 1997, interest at 7.625%, due July 1, 2007	<u>\$ 100</u>
<b>HRA Account</b>	
FWUA <sup>(2)</sup> Series 1997A, interest at 6.85%, due August 25, 2007	300
FWUA <sup>(2)</sup> Series 1999A, interest at 7.125%, due February 25, 2019	1,000
Citizens, Series 2004 A - I, variable interest rates, due July 1, 2024 <sup>(3)</sup>	<u>750</u>
Total HRA Account	<u>\$ 2,050</u>
Total PLA/CLA Account and HRA Account Bonds	<u>\$ 2,150</u>

Notes:

- (1) Florida Residential Property and Casualty Joint Underwriting Association (FRPCJUA).
- (2) Florida Windstorm Underwriting Association (FWUA).
- (3) With maturity dates beginning in 2016.

*APPENDIX D*  
*CITIZENS PROPERTY INSURANCE CORPORATION*  
*MANAGEMENT RESPONSES*

CITIZENS PROPERTY INSURANCE CORPORATION  
101 NORTH MONROE STREET, SUITE 1000  
TALLAHASSEE, FLORIDA 32301

TELEPHONE: (850) 513-3700 FAX: (850) 513-3900



January 23, 2006

William O. Monroe, C.P.A.  
Auditor General  
State of Florida  
G74 Claude Pepper Building  
111 West Madison Street  
Tallahassee, Florida 32399-1450

Dear Mr. Monroe:

Enclosed herewith please find our written statement of explanation concerning all of the findings contained in the list of preliminary and tentative audit findings and recommendations provided to us on December 28, 2005. We were pleased to find that your report acknowledged the substantial progress that Citizens has made in virtually all audit areas and that the draft report noted the actual or proposed corrective action.

We appreciate the opportunity for improvement that this audit has provided to us. We will use the findings of this report and other internal and external reports and audits to continue to improve our infrastructure, processes and procedures.

I would appreciate it very much if you would let me know when the final Audit Report will be released.

Sincerely,

A handwritten signature in blue ink that reads "Robert L. Ricker".

Robert L. Ricker  
President and Executive Director

RLR/bw  
Enclosure

cc: G. Bruce Douglas, Chairman  
Don Hancock, Audit Manager

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G. Bruce Douglas - Chairman, St. Johns County • Gloria Fletcher - Vice-Chair, Alachua County  
John Collins, Broward County • Cheryl Herrin, Hillsborough County • Earl Horton, Pinellas County • Jay Odom, Okaloosa County  
Julio Rebull, Jr., Miami-Dade County • Phillip Thomasson, Alachua County • Robert L. Ricker, Executive Director

*APPENDIX D (CONTINUED)***RESPONSES TO FINDINGS AND RECOMMENDATIONS OF THE OPERATIONAL  
AUDIT OF CITIZENS PROPERTY INSURANCE CORPORATION****Infrastructure**

The creation of operational infrastructure for Citizens, as a residual, ostensibly temporary insurer, was not a priority before 2005. The corporation and its Board appropriately focused on downsizing operations and outsourcing core insurance functions. However, the 2004 Hurricane Season and other external forces changed that dynamic. Faced with more than 120,000 catastrophe claims, and 30,000 or more new applications for coverage filed each month, which Citizens is obligated by law to insure, it became clear that the lack of infrastructure and heavy reliance on outsourcing was misplaced. Both the Task Force on Citizens Policyholder Services and Relations and the legislature itself in SB 1486 recognized that Citizens must create adequate operational infrastructure to properly process catastrophe claims and to assure that “policyholders, applicants, and agents of the corporation receive service and treatment of the highest possible level but never less than that generally provided in the voluntary market.”

Many of the changes necessary to meet this required new standard of service and to create the proper catastrophe operations infrastructure have already been made; others are in progress. The goal of these changes is to assure that Citizens has the “infrastructure, including a plan of organization, the systems, and the related internal controls that will provide reasonable assurance of the efficient, effective, and economical accomplishment of Citizens’ responsibilities, as established by law, contracts and insurance industry practice.”

**Finding No. 1: Enterprise Risk Management**

Management Response: Agree.

Citizens will continue, with the assistance of the Internal Auditor and other resources, to implement and document enterprise risk management processes. The Board will consider a plan to expand its Internal Audit department at its February Board meeting.

**Finding No. 2: Education and Experience Verifications**

Management Response: Agree.

Citizens will continue to employ a process to ensure that pre-employment education and experience verifications are performed for all prospective employees.

**Finding No. 3: Background Investigations**

Management Response: Agree.

Citizens will continue to require and enforce compliance with background investigations for new employees.



*APPENDIX D (CONTINUED)*

Citizens will comply with the expanded background investigation procedures for Senior Managers specified in its Plan of Operation. These procedures include a nationwide criminal background search, employment references, credit history, education verification, fingerprinting and financial disclosure.

The Legislature should clarify whether the provisions of Section 624.404(3) should apply to the Citizens Board as well as Senior Managers.

**Finding No. 5: Standards of Conduct**

Management Response: Agree.

The Legislature should amend Section 627.351(6)(c) to require that the Plan of Operation of Citizens adopt appropriate provisions of Part III of Chapter 112 and establish statutory penalties for violation of these provisions.

**Finding No. 6: Contractor Selection, Engagement, and Monitoring**

Management Response: Partially agree.

The Board has directed Citizens staff to develop a procurement policy by the February Board meeting. Although this proposed policy is not identical to that recommended herein, it incorporates the substantive recommendations.

**Finding No. 7: Travel Policy**

Management Response: Disagree.

There is no provision in Citizens' enabling legislation [Section 627.351(6)] that applies the state travel reimbursement policy to Citizens, including its consultants and independent contractors. If the state travel reimbursement policy were applied to the operation of Citizens, it would be impossible for Citizens to compete with the insurance industry for scarce catastrophe adjusting resources. Citizens would be unable to achieve its mission to provide coverage to and pay the claims of its 800,000 policyholders.

**Finding No. 8: Eligibility Determination**

Management Response: Partially agree.

The Legislature should consider additional ways to assure that Citizens issues policies only to those individuals who have no other voluntary market offer. (See recommendations one

***APPENDIX D (CONTINUED)***

and three under this heading.) One way to accomplish this goal is to repeal Consumer Choice (627.3517).

Citizens does not agree that it is reasonable, feasible or productive to attempt to determine whether an insurer is “actively writing new policies in the agent’s geographic area of operation.” Attempting to implement this provision would be extremely burdensome for OIR and would result in no meaningful gain. If the goal is to ensure that no market exists for risks that come to Citizens, a more effective solution would be to require that the application for coverage be “marketed” via an electronic bulletin board prior to being insured with Citizens.

**Finding No. 9: Market Assistance Plan**

Management Response: Agree.

The Market Assistance Plan will work more closely with OIR and will obtain and utilize additional information in its efforts to place risks.

**Finding No. 10: Take-Out Bonuses**

Management Response: Disagree.

Current statutory authority, enacted AFTER the enactment of Section 627.3511(2), directs the corporation to “adopt one or more programs subject to approval by the office for the reduction of both new and renewal writings in the corporation.” This language provides clear authority, subject to approval by the office, for the development of depopulation programs other than that provided for in Section 627.3511(2).

**Finding No. 11: Take-Out Program Long-Term Monitoring**

Management Response: Disagree.

There is no current provision in law that a take out company “permanently remove risks from Citizens.” The current requirement is that the policies be removed for a minimum of three years. Citizens, and the people of Florida, benefit tremendously from this reduction in exposure during this minimum three year period. It would be illogical, time consuming, and expensive to develop a complex individual property address tracking system to permanently track the status of a policy after the expiration of the three year period.

**Finding No. 12: Policyholder Systems**

Management Response: Agree.

*APPENDIX D (CONTINUED)*

Citizens will continue to expedite the implementation of its Single System Project and enhancement of its Claims Tracking System.

**Finding No. 13: Complaint Handling Procedures**

Management Response: Agree.

Citizens has already consolidated its complaint handling function and will continue to implement improvements throughout 2006.

**Finding No. 14: Monitoring of Contracted Adjuster Resources**

Management Response: Agree.

Citizens will continue the development of CTS and will better document its ongoing adjuster monitoring procedures.

**Finding No. 15: Catastrophe Claims Files**

Management Response: Partially agree.

Citizens agrees with the findings and recommendations on this portion of the report except for the conclusions related to ITV.

In 2004, Citizens deemed it unnecessary to require an ITV analysis on each catastrophe claim file. This action was appropriate because:

- 1) For wind policies, the insurer writing the underlying non-wind coverage utilizes replacement cost estimator software that establishes the value of the property;
- 2) For multi-peril policies, Citizens utilizes replacement cost estimator software, appraisals and other approved methods for establishing the value of property;
- 3) The coinsurance provision does not apply to a total loss and an ITV valuation was still required for total losses;
- 4) No payments in excess of policy limits were made; and
- 5) The proper time to address ITV is at issuance or renewal, when an insured and the agent can establish the property value, not during a catastrophe.

*APPENDIX D (CONTINUED)*

Additionally, OIR has confirmed that it would not have permitted any insurer to apply coinsurance provisions during the adjustment of a catastrophic loss where the ITV analysis was not completed at application or renewal.

**Finding No. 16: Actuarial Soundness of Rates**

Management Response: Agree.

Citizens has already complied with this recommendation by making an actuarially sound rate filing with OIR on December 30, 2005.

**Finding No. 17: Financing Options**

Management Response: Agree.

Citizens has entertained numerous proposals to reduce the negative arbitrage generated by the FWUA Series 199A Bonds. We will continue to entertain and evaluate creative, fiscally prudent solutions for this indebtedness.

APPENDIX D (CONTINUED)



OFFICE OF INSURANCE REGULATION

KEVIN M. McCARTY  
COMMISSIONER

FINANCIAL SERVICES  
COMMISSION  
  
JEB BUSH  
GOVERNOR  
  
TOM GALLAGHER  
CHIEF FINANCIAL OFFICER  
  
CHARLIE CRIST  
ATTORNEY GENERAL  
  
CHARLES BRONSON  
COMMISSIONER OF  
AGRICULTURE

January 23, 2006

Mr. William O. Monroe, CPA  
Auditor General  
State of Florida  
G74 Claude Pepper Building  
111 West Madison Street  
Tallahassee, Florida 32399-1450

Re: Preliminary and Tentative Audit Findings – Operational Audit in the case of  
Citizens Property Insurance Company


Dear Mr. Monroe:

This letter is being forwarded to you in response to your letter of December 28, 2005.

The Office of Insurance Regulation has reviewed the background information, findings and recommendations that were forwarded to us in an enclosure to your letter of December 28, 2005. The enclosed information, comments and responses are keyed to your letter to the extent that this could reasonably be achieved.

I appreciate the opportunity to review and respond to the preliminary and tentative findings.

Sincerely,

  
Kevin M. McCarty

TS/aec

Enclosure

Cc: Tom Gallagher, Chief Financial Officer, Department of Financial Services  
Robert L. Ricker, Executive Director and President, Citizens Property Insurance  
Company

• • •  
KEVIN M. MCCARTY • COMMISSIONER  
200 EAST GAINES STREET • TALLAHASSEE, FLORIDA 32399-0305 • (850) 413-5914 • FAX (850) 488-3334  
WEBSITE: WWW.FLDFS.COM • EMAIL: KEVIN.MCCARTY@FLDFS.COM

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*APPENDIX D (CONTINUED)***Information and comments prepared by the Office of Insurance Regulation in response to the Auditor General's audit of Citizens Property Insurance Company.**

The information and comments that follow are keyed to the preliminary and tentative audit findings and recommendations that were forwarded to the Office of Insurance Regulation (Office) in an enclosure to the Auditor General's letter of December 28, 2005.

**Finding No. 3: Background Investigations**

At its October Board meeting, the Board of Governors of Citizens voted to amend the plan of operation to require background screenings through the Office for all of the Senior Managers of Citizens. Their biographical affidavits have been submitted and reviewed as if for the officers of a licensed insurer. The amendment to the Citizens Plan of Operation has been approved by Order, a copy of which has been provided.

Members of the Board of Governors are subject to the background investigations required by their respective appointing officers. If the Legislature elects to modify Section 627.351(6)(c), Florida Statutes, this Office will review background screenings for appointees to the Citizens Board of Governors in the same manner that is currently required for directors of insurance companies pursuant to Section 624.404(3), Florida Statutes.

**Finding No. 9: Market Assistance Plan**

Section 627.3515(1), Florida Statutes, requires the Office to approve a market assistance plan. The section does not, however, require this Office to be directly involved in the operation and administration of the market assistance plan. Pursuant to previous conversation, the latest approval of the Plan associated with the Florida Market Assistance Program (FMAP) by the then Department of Insurance dated September 22, 1997 (copy attached<sup>11</sup>). This Order indicates that the initial plan was approved by the Department of Insurance on November 15, 1985.

Subsequent to initial approval of the Plan, the FMAP has been operated and administered by several public and private entities as directed by its governing board. Statutes do not specify that the Plan be approved at established intervals following its initial approval. On the other hand, this Office concurs with the Auditor General recommendations and remains committed to working closely with Citizens and the FMAP with a view toward placing as much business as possible in the voluntary market.

**Finding No. 10: Take-Out Bonuses**

It is this Office's statutory interpretation that the legislative intent is to provide the flexibility for development and implementation of alternative takeout bonuses in order to encourage the return of policies to the voluntary market. The bonuses established within those plans are to be appropriate for the characteristics of each plan. This Office supports the recommendation to seek clarification of current legislative intent in this regard and is committed to work with Citizens during the upcoming legislative session to obtain clarification.

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<sup>11</sup> Auditor's Note: The approving Order referenced in the Commissioner's response is a public record of the Office of Insurance Regulation and is not duplicated within this report.

*APPENDIX D (CONTINUED)***Finding No. 16: Actuarial Soundness of Rates**

This Office concurs with the recommendation associated with this finding, which is consistent with Order 78909-04 that was issued by this Office on November 17, 2004. Citizens subsequently submitted actuarial filings for the various programs during the last week of December 2005. These filings are currently under review by the Office.