



AUDITOR GENERAL

WILLIAM O. MONROE, CPA



OFFICE OF INSURANCE REGULATION

VIATICAL SETTLEMENT REGULATION

AND MARKET CONDUCT EXAMINATIONS

Operational Audit

SUMMARY

This operational audit covering the period March 1, 2004, through February 28, 2006, focused on the Office of Insurance Regulation (OIR), Specialty Products Administration's, (SPA) regulation of viatical settlement providers and OIR's market conduct examinations. As indicated by the following, our audit disclosed some opportunities for improvement:

Finding No. 1: OIR could enhance the current practice to identify potential conflicts of interest of its regulatory staff and management by annually requiring a statement regarding any known conflicts of interest.

Finding No. 2: Written policies and procedures related to OIR's regulation of viatical settlement providers could be enhanced.

Finding No. 3: OIR should require a supervisory review and approval of viatical license continuation evaluations.

Finding No. 4: SPA did not always document the authorization and disposition of investigations in the manner required by the SPA Investigator's Procedures Manual.

Finding No. 5: The Bureau of Market Investigations did not obtain independent verification of professional designations held by contracted examiners.

BACKGROUND

Effective January 7, 2003, Chapter 2002-404, Laws of Florida, created the Department of Financial Services, within which was created the Financial Services Commission (Commission), consisting of the Governor, the Attorney General, the Chief Financial Officer, and the Commissioner of Agriculture.

Within the Commission, the Office of Insurance Regulation (OIR) was established. OIR is primarily responsible for ensuring that insurance companies licensed to do business in the State of Florida are financially solvent, operating within applicable laws and regulations, and offering their insurance products at a fair and adequate rate that does not unfairly discriminate against the buying public.

FINDINGS AND RECOMMENDATIONS

Office-Wide Procedures

Finding No. 1: Annual Statements of Conflicts of Interest

OIR policy requires that personnel must sign a Prohibited Activities Statement (Statement) upon employment. This Statement provides the standards of conduct for State employees as detailed in Section 112.313(7), Florida Statutes, and prohibits employees from holding employment, contractual, or financial relationships with regulated entities. The policy

followed by OIR also requires that employees must report any such relationships within five working days of the employment or contractual application or offer, or within five working days of acquisition of financial interest.

Ensuring that examinations, investigations, and other regulatory activities are conducted free of conflicts of interest is a critical element of successful regulation as it provides assurance regarding the objectivity of regulatory personnel and activities. An undisclosed conflict of interest can have a detrimental effect on both the integrity of a particular investigation or examination, as well as OIR’s regulatory efforts as a whole. Assurance of the objectivity of personnel could be enhanced by supplementing the exception-based reporting with an annual statement identifying any known conflicts of interest.

Recommendation: We recommend OIR require from all OIR regulatory personnel and management annual statements identifying any known conflicts of interest. This information should be used by management when making work assignments.

Viatical Settlements

Chapter 626, Part X,¹ Florida Statutes, (the Viatical Settlement Act) defines the role OIR has in the licensure, revocation, suspension, and examination of viatical settlement providers. The Viatical Settlement Section was created within the Specialty Products Administration business unit (SPA) of OIR, to regulate viatical settlement providers.

A viatical settlement contract is a written agreement for the sale or transfer of a life insurance death benefit by the owner of the life insurance policy (viator) to the viatical settlement provider (VSP), prior to the death of the insured.

The VSP acquiring the life insurance policy death benefit is to pay the viator the death benefit, at a discounted amount, and becomes the irrevocable beneficiary of the life insurance policy, receiving the

full amount of the death benefit upon the death of the viator.

As of February 28, 2006, there were 9 active VSPs in the State. Information regarding VSP activity, as reported in the December 31, 2005, annual reports, is disclosed in Table 1.

Table 1
VSP Activity for the Fiscal Year Ended
December 31, 2005

Company	Total Number of Policies Purchased	Total Settlements Paid for Policies Purchased (Thousands)	Total Face Value of Purchased Policies (Thousands)
1	12	\$ 1,528	\$ 66,940
2	23	4,853	27,788
3	24	3,293	14,449
4	77	27,203	114,090
5	104	37,105	175,691
6	112	30,286	163,332
7	127	33,951	189,247
8	164	91,091	337,737
9	616	235,929	1,167,444
Totals	1,259	\$ 465,239	\$ 2,256,718

Finding No. 2: Viatical Settlement Provider (VSP) Policies and Procedures

Documenting processes through written policies and procedures facilitates communication of management direction and control, provides a reasonable basis for training new employees, and promotes consistent performance of those processes. Our audit disclosed that the written policies and procedures followed by SPA could be enhanced to better ensure the accomplishment of certain regulatory processes and to assist in the training of employees:

- The SPA *Field Examinations* Policy² provides guidance related to: the scope and objective of examinations; the conduct of examinations; working paper standards; draft reports of examination; exit conferences; review and issuance of reports of examination; and corrective action plans. The guidance provided by the *Field Examinations* Policy

¹ Sections 626.991 - 626.99295, Florida Statutes.

² The *Field Examinations* Policy is a general set of instructions for conducting all types of examinations within SPA.

could be improved by addressing how examiners should document tests, including sample selection and analysis. Specification of such documentation requirements better ensures the inclusion of the related information in examination working papers. The availability of such information facilitates supervisory review of the work performed and of the related examination conclusions.

- The VSP *Examination Procedures Checklist* (Checklist) provides specific methodology for conducting VSP examinations. However, the Checklist could be enhanced by including:
 - A requirement that the examiner review the SPA *Field Examinations Policy* prior to conducting an examination.
 - A listing of the objectives of the examination and an indication as to how each procedure relates to the objectives. The checklist currently contains only a list of procedures. The inclusion of examination objectives would provide examiners a better understanding of the purpose and role of particular required procedures in accomplishing examination objectives.
- Neither the *Viatical Settlement Provider Application Review Procedure Manual* nor the SPA *Investigator's Procedure Manual* had been updated to reflect current statutory citations or the transfer of regulatory responsibility from the former Department of Insurance to the Office of Insurance Regulation.
- Although SPA periodically performs actions to search for unlicensed VSP's, these actions had not been reduced to written policies and procedures.

Absent appropriate written policies and procedures, there is reduced assurance that regulatory activities for VSP's will be performed by SPA personnel in accordance with governing law, rules, and management intent.

Recommendation: We recommend that OIR continue to enhance and develop the written policies and procedures associated with its VSP regulatory functions.

Finding No. 3: Supervisory Review of the License Continuation Process

Section 626.9913(1), Florida Statutes, requires that each VSP licensee annually submit to OIR information such as audited financial statements, annual statements containing information required by the Commission, and a license fee. A license may be revoked or suspended if the information submitted indicates that the licensee, among other things, has violated any provision of the insurance code, demonstrated a pattern of unreasonable payments to viators, engaged in fraudulent or dishonest practices, or failed to maintain appropriate bond or security deposits.

The license continuation evaluation was to be documented through the completion of a *Compliance Review Checklist – Viatical Settlement Provider Form* (Checklist). The Checklist included the steps and analysis required by OIR examiners with respect to the determination of whether a license should be continued, revoked, or suspended. The required steps and analyses included both objective and subjective criteria. The Checklist also required the signature of supervisory staff to evidence the review and approval of the completed Checklist and related conclusions.

We selected for testing 8 of 16 license continuance evaluations (evaluations) performed during the audit period. Our tests disclosed that none of the 8 tested Checklists were signed by the supervisor, although 5 of the 8 evaluation files did contain some evidence of supervisory review of at least some aspects of the evaluations. The absence of documented supervisory review of the Checklists reduces the assurance that OIR's license continuation evaluations are appropriately performed.

Recommendation: We recommend that OIR require that the Checklists be reviewed by supervisory staff and signed and dated to evidence supervisory review and approval.

Finding No. 4: Documenting Investigations

According to SPA's *Investigator's Procedures Manual* (Manual), an investigation begins upon authorization

by the SPA supervisor, and “once a case is opened, it must be pursued until conclusion. That conclusion may be a recommendation that the file is closed, prosecuted administratively, or referred for further actions. In every case, the file must be well documented and clearly demonstrate every step taken to either prove or disprove an allegation.”

We reviewed the files for one of four VSP investigations conducted by SPA during the audit period. We noted that contrary to the Manual, there was no evidence documenting either the authorization to begin the investigation or the final disposition of the investigation (closed, prosecuted administratively, or referred for further actions). Upon inquiry, SPA indicated the investigation had been referred to the Office of Financial Regulation and no further action was taken by SPA. However, the investigation file did not contain documentation that such action had been taken.

The absence of complete investigative files reduces SPA’s ability to demonstrate that the investigations were properly authorized and that the conclusions were reviewed and approved.

Recommendation: We recommend that OIR take steps to ensure that all investigations are properly documented in accordance with the Manual.

Market Conduct Examinations

The Bureau of Market Investigations was created, in part, for the purpose of conducting market conduct examinations of insurers to ensure compliance with the Florida Insurance Code. Based upon the results of the market conduct examinations, the Insurance Commissioner may take administrative action, impose administrative penalties, and require corrective action in order to protect insurance consumers from unlawful or harmful business practices.

In conducting examinations, OIR uses the methodology described by the *Market Conduct Examiners Handbook* of the National Association of Insurance Commissioners (NAIC).

Finding No. 5: Verification of Professional Designations

A market conduct examination’s examiner-in-charge has the responsibilities of managing the examination and coordinating interaction with the licensee. The NAIC *Market Conduct Examiners Handbook (2004)* recommends that an Examiner-in-Charge shall be certified by the Insurance Regulatory Examiners Society as eligible to hold the designation of Certified Insurance Examiner.

The Bureau issued 62 market conduct examinations during the audit period. Of the 62 market conduct examinations issued, 61 were performed by contracted examiners. Our audit included testing of two of the market conduct examinations performed by contracted examiners. For the two tested market conduct examinations made by contracted examiners, the published examination reports indicated that the examiner-in-charge of the audit was a Certified Insurance Examiner. However, Bureau managers indicated that they did not, through the Insurance Regulatory Examiners Society, verify the professional designations of the assigned examiners-in-charge. The Bureau relied on the contractor to maintain appropriate certification.

Absent Bureau verification that the contracted examiners were certified, there was reduced assurance that the contracted examiners were certified and had the associated required skills and proficiencies to manage and coordinate market conduct examinations.

Recommendation: In order to provide assurance that the contracted examiners have the skill and proficiencies required to manage and coordinate market conduct examinations, we recommend that the Bureau verify professional designations held by the examiner-in-charge.

OBJECTIVES, SCOPE, AND METHODOLOGY

This operational audit focused on OIR’s regulation of viatical settlement providers and the performance of market conduct examinations. Our specific objectives were to:

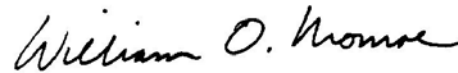
- Obtain an understanding and assess the effectiveness of OIR's internal controls over the areas of licensing, monitoring, examining, and the administration of regulatory actions related to viatical settlement providers.
- Obtain an understanding and assess the effectiveness of OIR's internal controls over the areas of risk analysis, selection of examiners, compliance with National Association of Insurance Commissioners' standards, and quality control procedures related to market conduct examinations.
- Evaluate OIR's compliance with selected controlling laws and other guidelines.

In conducting our audit, we obtained an understanding of governing laws and guidelines. We also reviewed OIR manuals, interviewed personnel, performed tests of compliance with applicable laws and rules, performed tests of pertinent records, and conducted tests of the effectiveness of relevant OIR controls.

Our audit included examinations of various transactions occurring during the period March 1, 2004, through February 28, 2006.

AUTHORITY

Pursuant to the provisions of Section 11.45, Florida Statutes, I have directed that this report be prepared to present the results of our operational audit.



William O. Monroe, CPA
Auditor General

MANAGEMENT RESPONSE

In a letter dated January 18, 2007, the Commissioner provided responses to our findings. The letter is included in its entirety at the end of this report as Appendix A.

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 operational audit was conducted in accordance with applicable *Generally Accepted Government Auditing Standards*. This audit was conducted by Melisa Hevey, CPA, and Richard Munson, CPA, and supervised by Allen Weiner, CPA. Please address inquiries regarding this report to Kathryn Walker, CPA, Audit Manager, via e-mail at kathrynwalker@aud.state.fl.us or by telephone at (850)487-9085.

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).

APPENDIX A
MANAGEMENT RESPONSE



OFFICE OF INSURANCE REGULATION

KEVIN M. MCCARTY
COMMISSIONER

**FINANCIAL SERVICES
COMMISSION**

CHARLIE CRIST
GOVERNOR

ALEX SINK
CHIEF FINANCIAL OFFICER

BILL MCCOLLUM
ATTORNEY GENERAL

CHARLES BRONSON
COMMISSIONER OF
AGRICULTURE

January 18, 2007

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

Re: Auditor General Letter Dated December 22, 2006 – Preliminary and Tentative Findings – Office of Insurance Regulation Viatical Settlement Regulation and Market Conduct Examinations

Dear Mr. Monroe:

This letter is being forwarded to you in response to referenced preliminary and tentative findings.

The Office of Insurance Regulation has reviewed the summary, background information and findings and recommendations that were forwarded to us as an enclosure to the referenced letter. Our responses are included in bold print in the enclosure to this letter.

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

Sincerely,

Kevin M. McCarty

LH/aec

Enclosure

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APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

Management Responses to Auditor General's Preliminary and Tentative Audit Findings -- Viatical Settlement Regulation and Market Conduct Examinations

Office-Wide Procedures

Finding No. 1: Annual Statements of Conflicts of Interest

OIR policy requires that personnel must sign a Prohibited Activities Statement (Statement) upon employment. This Statement provides the standards of conduct for State employees as detailed in Section 112.313(7), Florida Statutes, and prohibits employees from holding employment, contractual, or financial relationships with regulated entities. The policy followed by OIR also requires that employees must report any such relationships within five working days of the employment or contractual application or offer, or within five working days of acquisition of financial interest.

Ensuring that examinations, investigations, and other regulatory activities are conducted free of conflicts of interest is a critical element of successful regulation as it provides assurance regarding the objectivity of regulatory personnel and activities. An undisclosed conflict of interest can have a detrimental effect on both the integrity of a particular investigation or examination, as well as OIR's regulatory efforts as a whole. Assurance of the objectivity of personnel could be enhanced by supplementing the exception-based reporting with an annual statement identifying any known conflicts of interest.

Recommendation: We recommend OIR require from all OIR regulatory personnel and management annual statements identifying any known conflicts of interest. This information should be used by management when making work assignments.

Response:

The Office concurs that investigations, examinations and other regulatory activities must be conducted free of conflicts of interest. As such, the Office agrees that the current Conflict of Interest form needs to be updated by regulatory and management personnel on an annual basis. This is similar to the current procedure for dual employment and the Office shall address this through an updated Administrative Policy and Procedure (AP&P).

Viatical Settlements

Finding No. 2: Viatical Settlement Provider (VSP) Policies and Procedures

Documenting processes through written policies and procedures facilitates communication of management direction and control, provides a reasonable basis for training new employees, and promotes consistent performance of those processes. Our audit disclosed that the written policies and procedures followed by SPA could be

APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

enhanced to better ensure the accomplishment of certain regulatory processes and to assist in the training of employees:

- The SPA *Field Examinations* Policy provides guidance related to: the scope and objective of examinations; the conduct of examinations; working paper standards; draft reports of examination; exit conferences; review and issuance of reports of examination; and corrective action plans. The guidance provided by the *Field Examinations* Policy could be improved by addressing how examiners should document tests, including sample selection and analysis. Specification of such documentation requirements better ensures the inclusion of the related information in examination working papers. The availability of such information facilitates supervisory review of the work performed and of the related examination conclusions.

Response:

This office concurs that guidance could be improved and will revise procedures to include documenting tests, sample selections and exceptions that are noted.

- The VSP *Examination Procedures Checklist* (Checklist) provides specific methodology for conducting VSP examinations. However, the Checklist could be enhanced by including:
 - A requirement that the examiner review the SPA *Field Examinations* Policy prior to conducting an examination.
 - A listing of the objectives of the examination and an indication as to how each procedure relates to the objectives. The checklist currently contains only a list of procedures. The inclusion of examination objectives would provide examiners a better understanding of the purpose and role of particular required procedures in accomplishing examination objectives.

Response:

This Office concurs that the Checklist should be enhanced. The Examination Procedures will be enhanced to include a requirement that the examiner review the Field Examinations Policy and the applicable Procedure Manual prior to conducting an examination of a viatical settlement provider. The Examination Procedures Checklist will include a listing of the objectives of the examination and indicate how each procedure relates to the objectives.

- Neither the *Viatical Settlement Provider Application Review Procedure Manual* nor the *SPA Investigator's Procedure Manual* had been updated to reflect current statutory citations or the transfer of regulatory responsibility

APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

from the former Department of Insurance to the Office of Insurance Regulation.

Response:

This Office concurs with the recommendation. Both procedure manuals are being updated to reflect current statutory citations or transfer of regulatory authority from the former Department of Insurance to the Office of Insurance Regulation.

- Although SPA periodically performs actions to search for unlicensed VSP's, these actions had not been reduced to written policies and procedures.

Absent appropriate written policies and procedures, there is reduced assurance that regulatory activities for VSP's will be performed by SPA personnel in accordance with governing law, rules, and management intent.

Recommendation: We recommend that OIR continue to enhance and develop the written policies and procedures associated with its VSP regulatory functions.

Response:

This Office will continue to enhance and develop written policies and procedures that are associated with VSP regulatory functions.

Finding No. 3: Supervisory Review of the License Continuation Process

Section 626.9913(1), Florida Statutes, requires that each VSP licensee annually submit to OIR information such as audited financial statements, annual statements containing information required by the Commission, and a license fee. A license may be revoked or suspended if the information submitted indicates that the licensee, among other things, has violated any provision of the insurance code, demonstrated a pattern of unreasonable payments to viators, engaged in fraudulent or dishonest practices, or failed to maintain appropriate bond or security deposits.

The license continuation evaluation was to be documented through the completion of a *Compliance Review Checklist – Viatical Settlement Provider Form* (Checklist). The Checklist included the steps and analysis required by OIR examiners with respect to the determination of whether a license should be continued, revoked, or suspended. The required steps and analyses included both objective and subjective criteria. The Checklist also required the signature of supervisory staff to evidence the review and approval of the completed Checklist and related conclusions.

We selected for testing 8 of 16 license continuance evaluations (evaluations) performed during the audit period. Our tests disclosed that none of the 8 tested Checklists were signed by the supervisor, although 5 of the 8 evaluation files did contain some evidence of supervisory review of at least some aspects of the evaluations. The absence of

APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

documented supervisory review of the Checklists reduces the assurance that OIR's license continuation evaluations are appropriately performed.

Recommendation: We recommend that OIR require that the Checklists be reviewed by supervisory staff and signed and dated to evidence supervisory review and approval.

Response:

Currently, based on reviews of companies' annual reports, each company is assigned a priority code. These priority codes include:

- -- Major violations or problems;
- 2 -- Serious violations or problems;
- 3 -- Minor problems but the company is being monitored; and
- 4 -- No problems or violations have been noted.

Currently only those companies that have been assigned code 1 and code 2 require supervisory review. The eight companies that were tested during the audit were assigned priority code 4.

This Office will enhance procedures to eliminate any confusion concerning which companies require supervisory review and, subject to resource availability, will consider expansion of the supervisory review to include all companies regardless of its assigned priority code.

Finding No. 4: Documenting Investigations

According to SPA's *Investigator's Procedures Manual* (Manual), an investigation begins upon authorization by the SPA supervisor, and "once a case is opened, it must be pursued until conclusion. That conclusion may be a recommendation that the file is closed, prosecuted administratively, or referred for further actions. In every case, the file must be well documented and clearly demonstrate every step taken to either prove or disprove an allegation."

We reviewed the files for one of four VSP investigations conducted by SPA during the audit period. We noted that contrary to the Manual, there was no evidence documenting either the authorization to begin the investigation or the final disposition of the investigation (closed, prosecuted administratively, or referred for further actions). Upon inquiry, SPA indicated the investigation had been referred to the Office of Financial Regulation and no further action was taken by SPA. However, the investigation file did not contain documentation that such action had been taken.

APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

The absence of complete investigative files reduces SPA's ability to demonstrate that the investigations were properly authorized and that the conclusions were reviewed and approved.

Recommendation: We recommend that OIR take steps to ensure that all investigations are properly documented in accordance with the Manual.

Response: While the referenced file did include a copy of the referral to OFR, this Office agrees that the existing procedures should be more closely followed to ensure that investigations are properly documented in accordance with the Manual.

Market Conduct Examinations

The Bureau of Market Investigations was created, in part, for the purpose of conducting market conduct examinations of insurers to ensure compliance with the Florida Insurance Code. Based upon the results of the market conduct examinations, the Insurance Commissioner may take administrative action, impose administrative penalties, and require corrective action in order to protect insurance consumers from unlawful or harmful business practices.

In conducting examinations, OIR uses the methodology described by the *Market Conduct Examiners Handbook* of the National Association of Insurance Commissioners (NAIC).

Finding No. 5: Verification of Professional Designations

A market conduct examination's examiner-in-charge has the responsibilities of managing the examination and coordinating interaction with the licensee. The NAIC *Market Conduct Examiners Handbook (2004)* recommends that an Examiner-in-Charge shall be certified by the Insurance Regulatory Examiners Society as eligible to hold the designation of Certified Insurance Examiner.

The Bureau issued 62 market conduct examinations during the audit period. Of the 62 market conduct examinations issued, 61 were performed by contracted examiners. Our audit included testing of two of the market conduct examinations performed by contracted examiners. For the two tested market conduct examinations made by contracted examiners, the published examination reports indicated that the examiner-in-charge of the audit was a Certified Insurance Examiner. However, Bureau managers indicated that they did not, through the Insurance Regulatory Examiners Society, verify the professional designations of the assigned examiners-in-charge. The Bureau relied on the contractor to maintain appropriate certification.

Absent Bureau verification that the contracted examiners were certified, there was reduced assurance that the contracted examiners were certified and had the associated required skills and proficiencies to manage and coordinate market conduct examinations.

APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

Recommendation: In order to provide assurance that the contracted examiners have the skill and proficiencies required to manage and coordinate market conduct examinations, we recommend that the Bureau verify professional designations held by the examiner-in-charge.

Response: Market Investigations concurs that contracted examiners should have the skill and proficiencies required to manage and coordinate market conduct examinations. As such, Market Investigations agrees that verification of professional designations held by the examiner-in-charge should be performed and shall address this through development and implementation of an appropriate examination procedure.