

CITIZENS PROPERTY INSURANCE CORPORATION

Operational Audit

March 2006 Through February 2008 and Selected
Actions Through December 16, 2008



CITIZENS PROPERTY INSURANCE CORPORATION

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:

Andrea Bennett, from March 2007 to July 2008

John Collins, to March 2007

William Corry, from August 2008

Richard Dechene, from August 2006 to July 2008

G. Bruce Douglas, Chair, to July 2008

Carol Everhart, from March 2007

Gloria Fletcher, to July 2008

Cheryl Herrin, to February 2007

Earl Horton

Sherrill Hudson, from August 2008

Allan Katz, from March 2007

Carlos Lacasa, from February 2006 to March 2007, and from August 2008

James Malone, Chair and Member from August 2008

Jay Odom

Phil Thomasson, to July 2006

Robert L. Ricker, President and Executive Director, to November 2006

Scott Wallace, President and Executive Director, from November 2006

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CITIZENS PROPERTY INSURANCE CORPORATION
OPERATIONAL AUDIT

Table of Contents

	<u>PAGE NO.</u>
SUMMARY	1
BACKGROUND	3
FINDINGS AND RECOMMENDATIONS.....	5
INTERNAL CONTROLS	5
FINDING NO. 1: ENTERPRISE RISK MANAGEMENT	5
PERSONNEL AND PROCUREMENT.....	6
FINDING NO. 2: CONFLICT OF INTEREST DISCLOSURE FORMS.....	6
INFORMATION TECHNOLOGY CONTROLS.....	6
FINDING NO. 3: INFORMATION TECHNOLOGY SECURITY AWARENESS PROGRAM.....	7
FINDING NO. 4: INFORMATION TECHNOLOGY SECURITY CONTROLS	7
FINDING NO. 5: OTHER SECURITY CONTROLS	8
INTERNAL AUDIT.....	8
FINDING NO. 6: INTERNAL AUDIT POLICIES AND PROCEDURES.....	8
TAKE-OUT PROGRAMS AND BONUSES.....	9
FINDING NO. 7: TAKE-OUT PROGRAM LONG-TERM MONITORING.....	10
FINDING NO. 8: POLICYHOLDER NOTIFICATION.....	10
FINDING NO. 9: MARKET ASSISTANCE PLAN	11
CUSTOMER SERVICE	12
FINDING NO. 10: MANAGING STAKEHOLDER FEEDBACK	14
CLAIMS HANDLING	15
FINDING NO. 11: CLAIM ADJUSTMENT AND PAYMENT	15
FINDING NO. 12: MEDIATION AND APPRAISAL.....	16
UNDERWRITING	18
FINDING NO. 13: UNDERWRITING FILES.....	18
PROBABLE MAXIMUM LOSS FINANCING	19
FINDING NO. 14: FINANCING ARRANGEMENTS.....	19
PRIOR AUDIT FOLLOW-UP	21

CITIZENS PROPERTY INSURANCE CORPORATION
OPERATIONAL AUDIT

Table of Contents

	PAGE NO. (CONT.)
OBJECTIVES, SCOPE, AND METHODOLOGY.....	21
AUTHORITY.....	22
MANAGEMENT’S RESPONSE.....	22
EXHIBIT A.....	23

CITIZENS PROPERTY INSURANCE CORPORATION

SUMMARY

Citizens Property Insurance Corporation (Citizens) has been established to operate as the State's last resort insurer. As such, 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 to be placed with Citizens only when coverage is not available in the voluntary market. As of August 31, 2008, Citizens had 1,172,401 policies in force, with annualized premiums of \$2.7 billion and related loss exposure of \$433 billion.

Section 627.351(6)(l), Florida Statutes, requires the Auditor General to conduct an operational audit of Citizens every three years. The findings of our audit of the period March 1, 2006, through February 29, 2008, and selected actions taken through December 16, 2008, are summarized below.

Internal Controls

ENTERPRISE RISK MANAGEMENT

Finding No. 1: In audit report No. 2006-096, we noted that Citizens had no documentation to support that it had conducted an enterprise-wide evaluation of the effectiveness of operational and financial controls. Similarly, our current audit disclosed that no such evaluation had been completed during the audit period. However, on October 23, 2008, Citizens management presented to the Board a proposal to create an Enterprise Risk Management function that at a minimum will encompass risk management, compliance, and quality assurance.

Personnel and Procurement

CONFLICT OF INTEREST DISCLOSURE FORMS

Finding No. 2: Citizens' records in some instances did not contain a completed and signed Conflict of Interest Disclosure Form to evidence that the Citizens employees taking part in the evaluation and contract award processes were independent of, and had no conflict of interest with respect to, the vendors evaluated and selected. Additionally, we determined that in some instances, Citizens did not timely receive Conflict of Interest Disclosure Forms executed by the vendors.

Information Technology

SECURITY AWARENESS PROGRAM

Finding No. 3: Citizens had not established an information technology security awareness program. The purpose of a security awareness program is to inform personnel of the importance of the information they handle and the legal and business reasons for maintaining its integrity, confidentiality, and availability.

SECURITY CONTROLS

Finding No. 4: Effective security controls include access controls that ensure that users have only the access privileges needed to perform their duties, access to sensitive resources is limited to only a few users, and users are restricted from performing incompatible functions. Our audit disclosed deficiencies in certain security controls.

Finding No. 5: We noted certain other deficiencies in Citizens' security control features, the details of which have been disclosed to appropriate members of Citizens management.

Internal Audit

INTERNAL AUDIT PROCEDURES

Finding No. 6: Policies and procedures providing guidance for the internal audit activity had not been completed. The objective of such policies and procedures is to provide for the internal audit function an operational framework which reasonably ensures auditor compliance with governing auditing standards.

Take-Out Programs and Bonuses

TAKE-OUT PROGRAM LONG-TERM MONITORING

Finding No. 7: Section 627.351(6), Florida Statutes, as amended, required that effective July 1, 2007, in order to evaluate the costs and benefits of approved take-out plans, if Citizens pays a bonus or other payment to an insurer for an approved take-out plan, then Citizens shall maintain a record of all addresses or such other identifying information on the property or risk removed in order to track if and when the property or risk is later insured by the corporation. To address the requirements of the statute, Citizens developed a software application (application) to identify policies that may be returning to Citizens after having been assumed by a take-out insurer. The application was run monthly beginning in October 2007. However, the output from the application has not been reviewed by Citizens staff to determine what policies may be returning to Citizens from take-out insurers.

POLICYHOLDER NOTIFICATION

Finding No. 8: Insurers which were interested in considering the take-out of policies were to request from Citizens a selection file. In response to the request for a selection file, Citizens provided a data file to the prospective take-out insurer of all policies eligible for take-out. However, prior to March 11, 2008, when the selection file was provided, Citizens also communicated to the prospective take-out insurer that the policies written by certain insurance agencies or captive agents should not be selected, as the agencies or agents would be unable or unwilling to be appointed as an agent of the prospective take-out insurer and, thus, may not present a take-out proposal to the policyholder. Effective March 2008, Citizens was required by consent order of the Office of Insurance Regulation, to send notice to any policyholder whose policy has been selected for take-out, but whose agent is unable or unwilling to be appointed by the take-out insurer, that an offer of coverage was made which may have saved them premium dollars.

MARKET ASSISTANCE PLAN

Finding No. 9: Section 627.3515, Florida Statutes, 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. Section 627.3515(3)(a), Florida Statutes, as amended, also requires that the Plan and Citizens develop a business plan providing for the implementation of an electronic database for the purpose of confirming eligibility. Our audit disclosed:

- Additional opportunities to promote the Market Assistance Plan, and thereby increase its production of voluntary insurer placements, may exist through real estate professionals, mortgage companies and brokers, and others involved in the sale of real estate and the financing and refinancing thereof.
- The business plan was submitted to the Financial Services Commission, and in presenting the Plan, Citizens identified several potential implementation issues that required further consideration. As of December 16, 2008, further development of the proposed electronic database was pending.

Customer Service

MANAGING STAKEHOLDER FEEDBACK

Finding No. 10: Citizens has taken steps to improve customer service, including but not limited to, the establishment of a Consumer Services Department and a Consumer Services Committee, Web site enhancements, and the conduct of policyholder forums. In evaluating customer service issues, we surveyed

a sample of policyholders, analyzed complaint data maintained by the Department of Financial Services, and surveyed a sample of agents appointed by Citizens. The results of these surveys and analyses indicated that there remain opportunities for Citizens to further enhance customer service. One such opportunity involves the establishment of a central reporting mechanism to aggregate and evaluate customer service issues for Citizens as a whole.

Claims Handling

CLAIM ADJUSTMENT AND PAYMENT

Finding No. 11: With respect to claims reviewed, we evaluated 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, and the sufficiency of the steps taken by Citizens to review the findings of the adjusters. Our audit disclosed that some improvements were needed. Specifically:

- In audit report No. 2006-096, we noted that in adjusting claims, Citizens was not enforcing the 80 percent co-insurance clause in its various insurance policies. Our current audit again found few insurance-to-value analyses in the claim files reviewed.
- For some of the claims reviewed, Citizens did not appear to have taken sufficient action to subrogate claims.

MEDIATION AND APPRAISAL

Finding No. 12: Of the sixty reopened claims that we tested, we found that 28 went through mediation, appraisal, or lawsuit. For 26 of these 28 claims, a public adjuster had been hired by the policyholder. Our testing disclosed the following relating to the mediation and appraisal process:

- For 18 of the 28 reopened cases that went to mediation, appraisal, or umpire, either the public adjuster representing the policyholder or the public adjuster's firm performed the appraisal. This appears to be contrary to policy terms which require that appraisals be performed by a disinterested appraiser.
- There was no requirement that the umpires, in making award decisions, itemize or otherwise explain the rationale followed in determining the award, and in the files we reviewed, the umpire's award did not itemize the specific cost elements in the award or the rationale for the award.

Underwriting

UNDERWRITING FILES

Finding No. 13: Citizens' underwriters (internal and contracted) are required, at a minimum, to review the applications and supporting documentation and to make decisions concerning eligibility, insurability, and receipt of correct premium. Our tests of 30 applications, including policy renewals, disclosed in three applications issues that were not appropriately addressed.

Probable Maximum Loss Financing

FINANCING ARRANGEMENTS

Finding No. 14: Citizens should continue its efforts to reduce the cost-of-carry on any pre-event financing while maintaining the safety and liquidity of the financing proceeds through conservative investment.

BACKGROUND

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, Citizens' Plan of Operation required that Citizens operate subject to the supervision and approval of an eight-member Board of Governors (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. Also, in accordance with statute, the Plan of Operation required that Citizens' Executive Director and senior managers be engaged 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.

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

- A personal lines account (PLA) 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 (CLA) for commercial residential and commercial nonresidential 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 (HRA) 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.

Tables 1 and 2 summarizes by account, the policies in force, premiums, and exposure, as of August 31, 2007, and 2008:

Table 1

Citizens Policy in Force Report			
As of August 31, 2007			
Account	Policies in Force	Premiums	Exposure
Personal-Residential (PLA)	918,612	\$1,714,844,898	\$197,912,801,798
Commercial (CLA)	12,696	554,035,152	77,827,709,460
High-Risk (HRA)	430,345	1,237,420,179	219,748,005,354
Total	1,361,653	\$3,506,300,229	\$495,488,516,612

Table 2

Citizens Policy in Force Report			
As of August 31, 2008			
<u>Account</u>	<u>Policies in Force</u>	<u>Premiums</u>	<u>Exposure</u>
Personal-Residential (PLA)	713,310	\$1,115,899,122	\$139,503,398,875
Commercial (CLA)	10,489	391,981,926	61,035,543,182
High-Risk (HRA)	<u>448,602</u>	<u>1,190,446,781</u>	<u>232,608,110,324</u>
Total	<u>1,172,401</u>	<u>\$2,698,327,829</u>	<u>\$433,147,052,381</u>

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. The reduction in policies in force, premiums and exposure between August 31, 2007, and 2008, is primarily due to the transfer of risks through take-out programs to voluntary insurers.

In general, the premium due from a Citizens’ policyholder is derived by multiplying the insured value of the property by a premium rate. In finding No. 16 of audit report No. 2006-096, we reported that the premium rates that had been charged by Citizens were not supported by actuarial studies. Subsequently, actuarial studies were obtained by Citizens and rates based thereon were approved by the Office of Insurance Regulation (OIR) with an effective date of January 1, 2007. However, as directed by the provisions of Section 627.351(6)(m)4. through 5., Florida Statutes, the assessment of actuarially determined rates was postponed until January 1, 2010. Citizens’ actuary has estimated that for the years ended December 31, 2007, and 2008, the difference between the premiums that would have been due using actuarially-determined rates and the premiums actually authorized to be approximately \$414 million.

FINDINGS AND RECOMMENDATIONS

Internal Controls

Citizen’s Board and management have a responsibility for establishing 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 standards.

As described more fully below, we found that Citizens has made improvements in internal controls and other changes are in progress. We also found that there remain opportunities for improvement.

Finding No. 1: Enterprise Risk Management

In audit report No. 2006-096, we noted that Citizens had no documentation to support that it had conducted an enterprise-wide evaluation of the effectiveness of operational and financial controls. Similarly, our current audit disclosed that no such evaluation had been completed during the audit period. Such an evaluation may be accomplished through an Enterprise Risk Management function. This function provides a means through which management may for its financial and operational objectives and related strategies, identify, assess, and manage the associated risks.

On October 23, 2008, Citizens management presented to the Board a proposal to create an Enterprise Risk Management function that at a minimum will encompass risk management, compliance, and quality assurance.

Recommendation: We recommend that Citizens continue its implementation of an enterprise risk management function.

Personnel and Procurement

In audit report No. 2006-096, we reported several areas in which Citizens' personnel administration and Citizens' procurement practices were deficient. For example, we found that personnel policies and procedures did not require background checks, and procurement policies and procedures did not address competitive procurement processes. In response to the audit findings, the Legislature amended Section 627.351(6), Florida Statutes, to address these and other administrative matters. Our current audit disclosed that Citizens had implemented policies and procedures to implement these statutory requirements and that for the files and transactions tested Citizens had complied with the applicable requirements of law, except as indicated in the following finding.

Finding No. 2: Conflict of Interest Disclosure Forms

As part of the procurement process, Citizens' policy requires that the vendor, and any Citizens employee involved in any part of the evaluation or selection of a vendor, provide a completed and signed Conflict of Interest Disclosure Form.

Our audit tests disclosed that for 2 of the 10 procurements tested, Citizens' records did not contain a completed and signed Conflict of Interest Disclosure Form to evidence that the Citizens employees taking part in the evaluation and contract award processes were independent of, and had no conflict of interest with respect to, the vendors evaluated and selected. In 2 of these instances, the contract amounts totaled \$60,000 and \$350,000 and related to the procurement of telecommunication consulting services and janitorial services, respectively. Additionally, we determined that for 2 of the 10 procurements tested, Citizens' did not timely receive Conflict of Interest Disclosure Forms executed by the vendors. In these instances, the contract amounts ranged from \$1.6 million to \$8 million and involved the leasing of facilities and the procurement of telecommunications services, respectively. Such attestations help to ensure the fairness and objectivity of the procurement and contracting processes.

Recommendation: We recommend that Citizens ensure that employee and vendor conflict of interest statements are timely obtained and retained in Citizens' records.

Information Technology Controls

In order to accomplish the mission and objectives of Citizens, several informational technology application systems have been contracted for or developed. These systems include:

- Active Directory – A central component of the Windows platform. Provides the means to manage the identities and relationships that make up network environments.
- ePAS – A browser based policy and claims processing system. Currently processes PLA policy and claim transactions.
- Wind – HRA residential and commercial policy system, including claims and accounting functionality.
- eWind – A browser based policy and claims processing system for wind-only policies. Currently processes HRA policy and claim transactions.

- CSC Point – An AS400 based commercial residential multi-peril policy system.
- Claims Tracking System (CTS) – Daily and catastrophe claims tracking and adjuster management system. This system is integrated with ePAS and Wind.
- ImageRight – A document management system that has been tailored for use in the insurance industry.

Finding No. 3: Information Technology Security Awareness Program

Information technology (IT) user awareness is an essential component of an effective security program. The purpose of a security awareness program is to inform personnel of the importance of the information they handle and the legal and business reasons for maintaining its integrity, confidentiality, and availability. Our review disclosed that Citizens had not established a security awareness program. Although Citizens did provide to users periodic e-mail advisories that can provide a good opportunity to set forth concepts of IT security and data handling, security awareness programs should be ongoing to remind employees of their parts in the total security program. The absence of an ongoing security awareness training program and a related lack of users' knowledge regarding their responsibilities for the safeguarding of Citizens' data resources, could jeopardize the integrity, confidentiality, and availability of system resources.

On October 13, 2008, subsequent to audit inquiry, Citizens indicated that a vendor had been identified to help Citizens implement and deliver an information security awareness program.

Recommendation: We recommend that Citizens continue in its efforts to implement a security awareness program.

Finding No. 4: Information Technology Security Controls

Effective security controls include access controls that ensure that users have only the access privileges needed to perform their duties, access to sensitive resources is limited to only a few users, and users are restricted from performing incompatible functions. Access controls include the use of individual user identification codes (IDs) and passwords to allow the matching of system activities to the responsible user. Further, to help reduce the risk of errors and fraud and the concealment thereof, appropriate members of management should approve the access rights granted and periodically review and confirm the continuing appropriateness of granted access rights.

Our audit disclosed deficiencies in certain security controls. Specifically:

- For 6 of 20 user IDs tested, Citizens was unable to provide documentation showing that management had approved the related employee's network access. Citizens indicated that it was initiating a recertification project to assess system access rights for all Citizens IT user accounts.
- Citizens had implemented procedures to remove the access privileges of employees who terminated employment and for external users whose employment or contracts had been terminated. Such procedures required that notification of termination be provided, upon termination, to security administration. Upon receipt of notification, security administration was to revoke access privileges. Our tests disclosed 97 instances in which notification to security administration was not sent timely. In these instances, notification was provided on dates ranging from 6 to 751 days after the date of employee termination. Additionally, we identified 128 former employees whose access privileges had not been timely revoked. In 34 of these instances, access was revoked, but not until dates ranging from 6 to 763 days after the date of termination. In 94 of the 128 instances, the access privileges of the former employees had not been revoked as of the date of our audit test. Absent timely revocation of access privileges, data and IT resources are exposed to increased risks of loss, error, and unauthorized use. Citizens indicated that some of the instances identified by our audit had occurred in 2006 when procedures for processing employee actions were not fully in place. Citizens further indicated that

its IT function will work with human resources to improve procedures for timely reporting and processing employee actions.

Recommendation: We recommend that Citizens ensure that user access authorization documentation is appropriately maintained. We also recommend Citizens perform periodic reviews of access privileges to ensure that the access granted is appropriate and monitor compliance with procedures requiring the timely revocation of the access privileges of terminating employees and contractors.

Finding No. 5: Other Security Controls

Security controls are intended to protect the confidentiality, integrity, and availability of data and IT resources. Our audit disclosed certain security controls related to Citizens' IT systems, in addition to the matters discussed in finding Nos. 3 and 4, that needed improvements. We are not disclosing specific details of the issues in this report to avoid the possibility of compromising Citizens' data and IT resources. However, we have notified appropriate management of the specific issues. Without adequate security controls, the confidentiality, integrity, and availability of data and IT resources may be comprised, increasing the risk that data and IT resources may be subject to improper disclosure, modification, or destruction.

Recommendation: We recommend that Citizens implement the appropriate security controls to ensure the confidentiality, integrity, and availability of data and IT resources.

Internal Audit

Citizens' Internal Audit Department became functional in December 2004 with the hiring of an internal auditor and the Board's approval of the original internal audit charter in February 2005. Effective July 1, 2006, Section 15, Chapter 2006-12, Laws of Florida, created the Office of Internal Audit (Section 627.351(6)(h), Florida Statutes). A Chief, Audit and Inspections, was subsequently added in January 2007 to create a two-person internal audit department. In June 2007, both internal auditors left the employment of Citizens and the Board approved the retention of an external audit firm on a temporary basis. A new Chief Internal Auditor was hired in November 2007, a new charter was put in place in January 2008, and four other staff had been employed as of August 2008.

The Office of Internal Audit in its published audit reports, excerpts from Citizens' Audit Committee minutes, and the January 2008 charter indicate that the Internal Audit Department follows the International Standards for the Professional Practice of Internal Auditing (IIA Standards) published by the Institute of Internal Auditors. Auditing standards govern such matters as auditor proficiency, auditor competence, audit planning and supervision, the reporting of internal audit findings, and internal audit quality assurance.

Finding No. 6: Internal Audit Policies and Procedures

Publications of the Institute of Internal Auditors provide that internal audit activities are performed in diverse legal and cultural environments; within organizations that vary in purpose, size, complexity, and structure; and by persons within or outside the organization. While differences may affect the practice of internal auditing in each environment, compliance with IIA Standards is essential if the responsibilities of internal audit are to be met.

IIA Performance Standard 2040 – Policies and Procedures states, "The chief audit executive [Chief Internal Auditor] should establish policies and procedures to guide the internal audit activity." The objective of such policies and procedures is to provide for the internal audit function an operational framework which is to reasonably ensure auditor compliance with the governing auditing standards. Such policies and procedures had not yet been

implemented, although they were under development. Absent clear guidance in the internal audit activity’s policies and procedures, there is less assurance that internal audits will always be conducted in accordance with IIA standards.

Recommendation: Citizens should continue its efforts to develop policies and procedures necessary to guide the internal audit activity and ensure compliance with IIA standards.

Take-Out Programs and Bonuses

In an effort to encourage the return of policies to the voluntary market, Sections 627.351(6)(p)3.a., and 627.3511, Florida Statutes, authorize voluntary insurers to take-out Citizens’ policies. Any policy taken out, assumed, or removed from Citizens is, as of the effective date of the take-out, assumption, or removal, direct insurance issued by the insurer and not by Citizens, even if Citizens continues to service the policies. Take-out plans of voluntary insurers are subject to the approval of Citizens’ Board and OIR.

Citizens’ files show that since January 2003, a total of 954,993 policies from the PLA account and 142,989 policies from the non-PLA accounts (commercial and high risk accounts) had been taken out. Table 3 below, summarizes the policies taken out from the PLA account and the non-PLA account during the period January 1, 2003, through October 15, 2008.

Table 3

Citizens PLA and Non-PLA Take-Outs For the Calendar Years 2003 through 2008				
Calendar Year	PLA Policies	Exposure (000's)	Non-PLA Policies	Exposure (000's)
2003	28,219	\$ 8,140,682	0	\$ -
2004	145,959	29,161,307	12,457	1,501,769
2005	218,128	40,174,893	75,556	13,483,947
2006	26,225	6,548,575	41,628	9,089,015
2007	247,887	68,259,426		-
2008 ¹	<u>288,575</u>	<u>80,696,815</u>	13,348	4,688,127
Total	<u>954,993</u>	<u>\$ 232,981,698</u>	<u>142,989</u>	<u>\$ 28,762,858</u>

¹Through October 15, 2008

Source: Citizens' Take-Out Program data file.

To encourage voluntary insurers to take out policies, Section 627.3511(2),¹ 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. Since March 2006, only one insurer had taken out a sufficient number of policies to qualify for the payment of a bonus. In this instance, a total of 26,728 policies were taken out on August 14, 2007.

Section 627.3511(5), Florida Statutes, provides that if policies taken-out are cancelled or nonrenewed by the insurer, the bonus amount is subject to proration for the time period the policies were insured.

¹ Chapter 2006-12, Laws of Florida, amended this statute effective January 1, 2008. to align the amount of bonus to that authorized in Section 627.3511, Florida Statutes.

Finding No. 7: Take-Out Program Long-Term Monitoring

In audit report No. 2006-096, finding No. 11, we recommended that Citizens ensure that a complete property address be maintained for all insured properties and that this information also be maintained for all properties that were removed by take-out agreements. In the finding, we recommended that this information 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. Subsequent to the issuance of the audit report, Section 627.351(6), Florida Statutes, was amended to require that effective July 1, 2007, in order to evaluate the costs and benefits of approved take-out plans, if Citizens pays a bonus or other payment to an insurer for an approved take-out plan, then Citizens shall maintain a record of all addresses or such other identifying information on the property or risk removed in order to track if and when the property or risk is later insured by Citizens.

To address the prior audit recommendation and the amendment of the statutes, Citizens developed a software application (application) to identify policies that may be returning to Citizens after having been assumed by a take-out insurer. The application was run monthly beginning in October 2007. However, the output from the application has not been reviewed by appropriate staff to determine what policies may be returning to Citizens from take-out insurers.

Absent the review and analysis of this data, Citizens may miss opportunities to identify policies returning to Citizens from take-out insurers, follow-up on why the policies are returning, and develop strategies to strengthen current take-out programs. In response to our inquiry, Citizens management stated that this application will be utilized in the future to ensure that take-out insurers are in compliance with the law and all contractual agreements.

Recommendation: We recommend that Citizens perform long-term monitoring on the take-out programs by reviewing the application output to identify policies returning to Citizens from take-out insurers, follow-up on why the policies are returning, and develop strategies to strengthen current take-out programs.

Finding No. 8: Policyholder Notification

Insurers which were interested in considering the take-out of policies were to request from Citizens a selection file. In response to the request for a selection file, Citizens provided a data file to the prospective take-out insurer of all policies eligible for take-out. However, prior to March 11, 2008, when the selection file was provided, Citizens also communicated to the prospective take-out insurer that the policies written by certain insurance agencies or captive agents² should not be selected, as the agencies or agents would be unable or unwilling to be appointed as an agent of the prospective take-out insurer and, thus, may not present a take-out proposal to the policyholder. In those instances in which the policies written by certain insurance agencies and captive agents were excluded from the prospective take-out insurer's consideration, the opportunity for the removal of policies from Citizens and the opportunity for a policyholder to obtain a reduced premium were foregone.

Effective March 11, 2008, the OIR issued consent order 94539-08, "Order Approving Citizens Property Insurance Corporation's Personal Residential and Commercial Residential Non-Bonus Takeout Plans." This consent order provided, in part, that "CITIZENS shall discontinue this notice [notice that policies of certain insurance agencies and captive agents should not be selected] so that the takeout companies will make their selections without categorically eliminating policies from eligibility for removal." In addition, to ensure that the policyholders are made aware of any

² Captive agents are insurance agents working exclusively for a single voluntary insurer, as opposed to an independent agent who may have been appointed by several insurers.

offers of coverage that may not be communicated by their agent, the order requires Citizens to send notice to any policyholder whose policy is selected for take-out, but whose agent is unable or unwilling to be appointed by the take-out insurer, that an offer of coverage was made which may have saved the policyholder premium dollars.

Recommendation: We recommend that in administering its responsibilities under the take-out programs, Citizens comply with the consent order.

Finding No. 9: Market Assistance Plan

Section 627.3515, Florida Statutes, establishes the Market Assistance Plan (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 kind and class of insurance in this State. 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.

The Plan provided a variety of programs for consumers, agents, and insurance companies. As shown by Table 4, during the period January 2006 through March 2008, the Plan provided agents with the names of over 120,000 customers who were trying to obtain property and casualty insurance, of which approximately 9,800 were placed with voluntary insurers. There were approximately 230 agents participating in the Plan.

Table 4

Florida Market Assistance Placements			
Calendar Year	Requests Through Plan for the Year	Voluntary Placements Through Plan for the Year	Percent Requests Placed
2006	61,382	4,692	7.64
2007	49,598	3,971	8.01
2008 ¹	9,118	1,192	13.07
Totals	120,098	9,855	8.21

¹ Through March 31, 2008

Source: Citizens

Section 627.3515, Florida Statutes, 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. Section 627.3515(3)(a), Florida Statutes, as amended effective January 25, 2007, also requires that the Plan and Citizens develop a business plan providing for the implementation of an electronic database for the purpose of confirming that the applicant is eligible for coverage by Citizens because the applicant is unable to obtain insurance coverage in the voluntary market. The business plan was to be presented to the Financial Services Commission for approval by September 1, 2007.

Our audit disclosed that:

- Promotion of the Plan’s use was accomplished primarily through the Web sites of Citizens, OIR, the Department of Financial Services, and various other insurance and news-related organizations. Additional opportunities to promote the Plan, and thereby increase its production of voluntary insurer placements, may exist through real estate professionals, mortgage companies and brokers, and others involved in the sale of real estate and the financing and refinancing thereof.

- Citizens submitted the “Proposed Electronic Eligibility Database Business Plan” on August 31, 2007, to the Financial Services Commission. Citizens concluded:

“The legislative intent of s. 627.3515(3)(a), Florida Statutes seems to be to ensure that only those applicants that meet the eligibility requirements set forth by the Florida Legislature are insured by Citizens. However, participation in the proposed electronic eligibility database is purely voluntary. The statute referenced above does not mandate compliance by insurer and or/agents. Therefore, there is no effective guarantee that implementing an electronic eligibility database of this nature will be effective. Additionally, there are other implementation issues, such as privacy concerns and enforcement issues that may also affect the success of this program. It is true that an effectively created and efficiently functioning electronic database could potentially result in fewer risks being written by Citizens and therefore could reduce future growth in exposure and number of policies in force. However, there may be serious customer service issues such as lapses in coverage, difficulty in creating and maintaining this database, company and agent enforcement problems and costs of development and maintenance which may mitigate against any success this program could produce.”

As described above, the business plan was submitted to the Financial Services Commission, and in presenting the Plan, Citizens identified several potential implementation issues that required further consideration. As of December 16, 2008, further development of the proposed electronic database was pending.

Recommendation: We recommend that the Plan consider additional opportunities and methods that may be used to promote the use of the Plan. We also recommend that any obstacles to the development of the electronic eligibility database be presented to the Legislature for evaluation.

Customer Service

Since our last audit, Citizens has taken steps to improve customer service, including but not limited to, the establishment of a Consumer Services Department and a Consumer Services Committee, Web site enhancements, and the conduct of policyholder forums. In evaluating customer service issues, we surveyed a sample of policyholders, analyzed complaint data maintained by the Department of Financial Services, and surveyed a sample of agents appointed by Citizens. The results of these surveys and analyses are presented below and, in summary, indicate that there remain opportunities for Citizens to further enhance customer service.

Policyholder Surveys

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 500 policyholders, including 200 who had filed claims. 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 the services provided by Citizens’ agents, Citizens’ call center operations, and overall satisfaction with their insurance policies. We received 117 responses to our survey from policyholders. Our evaluation of the results for all surveyed policyholders, 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 number of respondents reported being dissatisfied with their claims handling experiences. In comparison to the measurements of customer service satisfaction reported in audit report No. 2006-096, the percentage of satisfied to very satisfied policyholders showed relatively little change.

Table 5

Customer Service Survey					
	Somewhat Dissatisfied to Dissatisfied		Satisfied to Very Satisfied		Total Responses¹
	Number	Percentage	Number	Percentage	
Policy Issuance	22	19%	91	81%	113
Policy Renewal	21	20%	85	80%	106
Claims Handling	13	38%	21	62%	34
Agent Service	16	16%	87	84%	103
Call Center Operations	6	18%	28	82%	34
Overall	19	18%	89	82%	108

¹ Not all 117 policyholders responded to every question.

Source: Policyholder Surveys

Complaints

As part of our audit of Citizens’ customer service function, we analyzed Department of Financial Services (DFS), Division of Consumer Services, data available for the period March 1, 2006, through September 30, 2007, to identify any indications of significant customer service issues. As shown in Table 6, we found that during this period, Citizens ranked second among the top 11 Florida residential, commercial, and other property and casualty insurers in terms of the number of complaints as a percentage of policies in force as of September 30, 2007.

Table 6

Complaints as a Percentage of Policies in Force at September 30, 2007			
Company	Complaints as a Percentage of Policies in Force	Complaints for the Period March 1, 2006, through September 30, 2007	Policies in Force at September 30, 2007
1	0.679	1,638	241,218
Citizens	0.675	9,318	1,313,627
2	0.334	455	136,175
3	0.309	1,123	363,574
4	0.026	278	106,755
5	0.252	517	204,868
6	0.241	291	120,629
7	0.024	2,457	1,024,223
8	0.208	267	128,338
9	0.192	287	149,518
10	0.071	136	192,631

Source: Office of Insurance Regulation, and the DFS, Division of Consumer Services

We did note recent improvement in that Citizens experienced a 64 percent decrease in complaints for the period March 2007 through February 2008, as compared to the period March 2006 through February 2007.

Survey of Agents

As part of its operations, Citizens appoints agents to serve policyholders and act as the first line of customer service. Consequently, it is critical to the effective and efficient operations of Citizens that its agents have the necessary resources to cost-effectively serve policyholders including adequate training, the availability of policyholder information electronically, and consistent support from Citizens’ underwriting, claims, and other staff. To measure agent satisfaction with the provisions made by Citizens and to identify potential areas where Citizens could enhance its operations with respect to its appointed agents, we mailed surveys to 200 appointed agents. Questions were included in the survey to gauge agent satisfaction with, among other things, Citizens’ training program, its primary electronic policy administration systems (ePAS, eWind, eDOCS, and the Commercial Policyholder System), service provided by Citizens’ staff, and overall satisfaction with Citizens’ agent support. Our evaluation of the survey results, as shown by Table 7, indicated that most agents were satisfied with Citizens’ operations, including its training program, electronic policy administration systems, and overall support provided to them.

Table 7

Appointed Agent Survey					
	Somewhat Dissatisfied		Satisfied to Very Satisfied		Total Responses¹
	Number	Percentage	Number	Percentage	
Agent Certification Program	9	12%	64	88%	73
Training	3	5%	62	95%	65
ePAS	3	4%	70	96%	73
eWind	2	3%	60	97%	62
eDOCS	4	6%	60	94%	64
Commercial Policyholder System	6	19%	25	81%	31
New Policy Issuance	13	17%	64	83%	77
Policy Renewal	3	4%	71	96%	74
Service	10	18%	47	82%	57
Overall Agent Support	6	8%	71	92%	77

¹ Not all 82 agents responded to every question.

Source: Agent Surveys

Finding No. 10: Managing Stakeholder Feedback

Citizens’ reports that customer service takes place through various Citizens’ business units including Claims, the Technical Resource Center, Agent Services, and Underwriting. According to Citizens, this approach is used to more closely link customers to business unit experts. In such a de-centralized customer service environment it is important that customer service information is aggregated at a corporate level to better identify and trend customer service issues. Our audit found that Citizens had not established a central reporting mechanism to aggregate and evaluate customer service issues for Citizens as a whole. While, as indicated above, Citizens has instituted a Department of Consumer Services which is responsible for tracking and coordinating the handling of all written consumer complaints, absent the ability to track and evaluate all customer service issues (questions, complaints, etc.), Citizens capacity to identify and trend stakeholder issues and respond accordingly is limited.

Recognizing the importance of the need to aggregate information on all customer service issues, Citizens has begun to take steps to implement a single, formal process for managing stakeholder communication and feedback. These measures have included:

- Enhanced customer service training for all Citizens employees.
- The President's conduct of senior management leadership meetings.
- Centralization of Citizens communication regarding customer service.
- Implementation of a complaint handling and tracking systems (CHATS) which will automate Citizens' tracking and handling of complaints. CHATS will also have the capability of handling and tracking all communication and consumer issues and is tentatively scheduled to "go live" February 1, 2009.

Recommendation: Citizens should continue its efforts to implement a corporate-wide system that will facilitate the aggregation and evaluation of all customer service issues.

Claims Handling

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, 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:

- 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.
- 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 policyholder's claim.
- Evidence that a reserve has been established in an amount consistent with the most recent estimate of the damages incurred.

Finding No. 11: Claim Adjustment and Payment

We examined 202 claim files totaling \$34,284,420, including 60 claims totaling \$14,590,062 which were coded as reopened. 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, and the sufficiency of the steps taken by Citizens to review the findings of the 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:

- In audit report No. 2006-096, we noted that in adjusting claims, Citizens was not enforcing the 80 percent co-insurance clause that has been included in its various insurance policies. Our current audit again found few insurance-to-value analyses in the claim files reviewed. Citizens' Chief of Internal Audit, in a report dated October 17, 2008, also disclosed a similar observation.

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 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.

- Subrogation is the process by which an insurance company takes action to recover the amount of a claim from a third party whose action caused the loss. For some of the claims reviewed, Citizens did not appear to have taken sufficient action to subrogate claims. Specifically:
 - Citizens paid \$6,227 to repair fire damage to a tenant-occupied property. The tenant had fallen asleep while cooking and a fire resulted. Claim information did not indicate that Citizens had pursued the tenant for payment of damages.
 - Citizens paid \$7,716 to repair damage in a 3rd floor condominium unit caused by a leak that originated in a 4th floor unit. To subrogate the claim, Citizens mailed a letter to the owner of the 4th floor condominium unit. However, the letter was returned by the postal service as not deliverable as addressed. No further action in pursuit of damages was identified by the applicable claim files.
- Generally, the claim files reviewed demonstrated good faith in the handling of the claim and contained support in justification of the amounts paid. However, we did note one claim in which Citizens paid \$13,438 to replace the ceramic tile on the first floor of a policyholders residence. The reported event giving rise to the claim was the dropping of a pot, which caused a small chip in a single tile. The claim handling documents did not explain why all of the tile had to be replaced in lieu of the replacement of the one damaged tile. Had only the one damaged tile been replaced, the costs of repair would not have exceeded the policy's \$2,500 deductible.

Recommendation: We recommend that Citizens complete insurance-to-value analyses and, when necessary and appropriate, enforce the 80 percent co-insurance policy clauses. We also recommend that Citizens pursue subrogation of losses when appropriate. In those cases in which subrogation is available, but not pursued, we recommend that claim files contain notes explaining why subrogation was not pursued. Lastly, we recommend Citizens determine, where appropriate, that replacement items can be matched thereby reducing the amount of the claims adjusted.

Finding No. 12: Mediation and Appraisal

In the event that Citizens and the policyholder cannot agree on the amount of the loss, the policies allow for mediation or appraisal. Mediation is the process by which Citizens and the policyholder agree to resolve their differences in the amount of the loss through the use of a mediator.

Appraisal is an option through which Citizens and the policyholder are to each choose a competent and disinterested appraiser to determine the amount of the loss. If the appraisers can agree on an amount, then that will be considered the amount of the loss. If the appraisers cannot agree on an amount, the matter is to be submitted to an independent umpire. An amount agreed to by any two parties (the appraisers or an appraiser and the umpire) will then be considered the amount of the loss. Each party is responsible for the cost of its appraisers and attorneys and shall split all other expenses of the appraisal and the umpire.

Of the sixty reopened claims that we tested, we found that 28 went through mediation, appraisal, or lawsuit. For 26 of these 28 claims, a public adjuster had been hired by the policyholder. Our testing disclosed the following relating to the mediation and appraisal process:

- For 18 of the 28 reopened cases that went to mediation, appraisal, or umpire, either the public adjuster representing the policyholder or the public adjuster's firm also performed the appraisal. The public adjusters (or firms) performing the appraisals in these cases may not have been disinterested parties or free of conflicts of

interest.³ By allowing a public adjuster who will receive a payment from the claim proceeds to also perform the appraisal of the loss, Citizens may receive reduced assurance that a fair and impartial appraisal amount will be derived.

- There was no requirement that the umpires, in making award decisions, itemize or otherwise explain the rationale followed in determining the award, and in the files we reviewed, the umpire's award did not itemize the specific cost elements in the award or the rationale for the award. In many of these cases, the difference between the losses estimated by Citizens and the losses awarded by the umpire were substantial. For example:
 - The policyholder had engaged a public adjuster to represent it for a Hurricane Wilma claim for the repair a portion of the outer walls of several floors of a 20 story condominium. Citizens had hired structural engineers to examine and work with contractors on repairs. The engineer had noted that age deterioration and wood rot caused some of the damage and this damage was not covered by the policy. Citizens had determined the amount of the claim to be \$5.7 million on a \$22.9 million policy. A public adjuster estimated \$33 million was needed for repairs. The claim went to the appraisal and umpiring process and the umpire awarded \$22.9 million to policyholder.
 - A policyholder hired a public adjuster to provide representation for a Hurricane Wilma claim for the replacement of a cedar tongue-in-groove ceiling with water damage. The umpire awarded the policyholder an additional \$95,283.
 - A policyholder had hired a public adjuster to provide representation for a Hurricane Wilma claim relating to a damaged roof. An engineer engaged by Citizens to determine the extent of damage to the roof had provided a report indicating that only 2 percent of the roof had been damaged by winds and that the observed loose tiles were a result of depreciation and improper bedding during installation. Citizens and the policyholder adjuster went to mediation and then appraisal, which resulted in an umpire approving an award for an additional \$70,400 to pay for a new roof.

In an effort to address the mediation, appraisal, and umpire process, Citizens Board of Governors has approved amendments to Citizens policy forms that would:

- Require the parties (the insured claimant and Citizens) to agree to a "memorandum of appraisal" listing the specific items to be appraised.
- Require each appraiser, and the appraisal award, to separately set the amount of the damage for each item listed in the memorandum of appraisal.
- Require that the amount of the loss as determined in the appraisal process be adjusted for prior payments, policy deductibles and all policy conditions.
- Limit the time period in which the insured and Citizens may demand appraisal.
- Require the public adjuster (when the insured is represented by public adjuster) to submit to examination under oath and recorded statements, as the insured is required to do.

Citizens' staff is reconsidering whether to move forward with these amendments or, instead, whether it should eliminate appraisal from its policy forms (in which case these disputes would be resolved through litigation). Approval of OIR is required for any of these changes to take effect.

Recommendation: We recommend that Citizens continue to evaluate its options relating to the handling of mediation, appraisal, and umpiring and select an option which ensures the fair treatment of policyholders and full disclosure of all decisions made relative to the claim amounts ultimately paid. Should appraisal be retained as an option, we recommend that Citizens amend its policy forms to include the criteria to be used by Citizens and the policyholders in determining that the appraisers selected are competent and disinterested.

³ Section 626.8795, Florida Statutes, requires public adjusters not serve in a capacity that may be considered a conflict of interest.

Underwriting

Citizens' Agent Appointment Agreement requires that agents, in accordance with the procedures established by Citizens, shall be responsible for assuring that all submitted applications are complete and accurate and in compliance with applicable application requirements for that coverage. All documents that are received from agents whether electronically or by mail are entered into Citizens' imaging system.

Citizens' underwriters (internal and contracted) are required, at a minimum, to review the applications and supporting documentation and to make decisions concerning eligibility, insurability, and assessment of the correct premium. The underwriters' work is to be reviewed on a sample basis by a lead senior underwriter, and product development staff are to perform quality assurance reviews of underwriters' work.

Finding No. 13: Underwriting Files

Our tests of 30 applications, including policy renewals, disclosed issues in three applications that were not appropriately addressed:

- Two policies reviewed were for renewals of coverage for policies that were transferred to Citizens from Atlantic Preferred Insurance Company and Southern Family Insurance Company (subsidiaries of the Poe Insurance Company) upon Poe Insurance Company's liquidation. Underwriting issues were detected in both of the policies reviewed. Specifically:
 - One commercial residential multi-peril policy included \$2,750,000 coverage with an 80 percent coinsurance clause. Although the commercial underwriting guidelines required a current appraisal (not older than 18 months) for each separately scheduled building to be insured, only an illegible appraisal could be found in the imaging system. On February 27, 2007, a legible copy of an appraisal dated August 9, 2006, was submitted by the policyholder, together with a request to change the value insured to 100 percent coverage. The appraisal indicated a value of \$3,800,000. The value shown by the August 9, 2006, appraisal indicated that the insured had been receiving 80 percent coinsurance coverage, but paid premium on only 72.4 percent of the appraised value.
 - One personal residential multi-peril policy received a protective device discount totaling \$285. Although the underwriting rules require a legible copy of the certificate of installation that includes a monitoring agreement or a current legible copy (not more than one year-old) of a monitoring subscription agreement, there was no documentation available in the imaging system to support that any monitoring agreements were received.

Further inquiry disclosed that due to the high volume of renewals over a 12 month period for these transferred policies (over 300,000 policies), Citizens management determined that all applications submitted by Citizens agents for the former Poe Insurance Company insured properties would be approved without undergoing normal underwriting review procedures.

- One personal residential multi-peril policy which included \$300,000 in personal liability coverage was approved with a swimming pool. Although the underwriting rules required that properties with pools and similar structures be completely fenced, walled, or screened to be eligible for liability coverage, a picture of the back of the property disclosed that the pool was not enclosed completely by a fence.

Absent a more thorough underwriting review process, Citizens may provide insurance to risks that are not eligible, may not receive the proper amount of premium, and may ultimately pay claim amounts in excess of the amounts due.

Recommendation: We recommend that Citizens ensure that underwriters are properly approving policies for only insurable risks, at the correct values, and all documentation supporting discounts and credits is received and entered into the imaging system. We also recommend that Citizens review the transferred policies prior to any further renewals.

Probable Maximum Loss Financing
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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).⁴ 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). At November 30, 2007, the estimated 100-year PMLs for the PLA/CLA and HRA accounts were \$9.75 billion and \$15.115 billion, respectively.

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 policyholder surcharges.
- Private market reinsurance.
- Reinsurance from the Florida Hurricane Catastrophe Fund (FHCF).
- Borrowed funds, such as, lines of credit and bond issues.

Finding No. 14: Financing Arrangements

In order to have sufficient cash on hand to pay catastrophic losses, Citizens has provided for liquidity through the issuance of pre-event bonds, (bonds issued in anticipation of storm events). Because the cash must be available to pay claims when needed, 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 is matched as closely as possible to expected rates of return on conservatively invested proceeds. Our review of the effectiveness of the steps taken by Citizens to maintain the safety and liquidity of the invested proceeds and to minimize the cost-of-carry disclosed:

- As shown in Table 8, as of September 30, 2008, Citizens had incurred realized and unrealized losses of \$229,508,981 on four holdings of asset-backed commercial paper managed for Citizens by the State Board of Administration. Also, Citizens' investment in the Local Government Surplus Fund Trust Fund (LGSFTF) similarly incurred losses due to these four specific investments. Citizens has since increased its monitoring efforts and revised its investment policy effective July 1, 2008, to specifically exclude the purchase of asset-backed commercial paper.

⁴ A 1-in-100 year storm is defined as a storm having a 1 percent (1/100) chance of occurrence in any year.

Table 8

Losses Due to Asset-Backed Commercial Paper as of September 30, 2008			
<u>Investment</u>	<u>Realized Losses</u>	<u>Unrealized Losses</u>	<u>Total Losses</u>
Axon Financial Funding, LLC	\$ 101,137,500	\$ 32,737,500	\$ 133,875,000
Ottimo Funding LTD	24,390,184	882	24,391,066
KKR Atlantic Funding Trust	23,192,729	18,460,324	41,653,053
KKR Pacific Funding Trust	15,830,392	13,759,470	29,589,862
LGSFTF	18,502,480	-	18,502,480
Total	\$ 183,053,285	\$ 64,958,176	\$ 248,011,461

Source: Citizens

- Interest expense paid on the pre-event bonds significantly exceeded the amounts earned on the proceeds for the period June 2006 through May 2008. Citizens structured these pre-event bonds as auction rate bonds.⁵ A combination of the above-described investment losses on asset-backed commercial paper, and the increasing interest rates on the pre-event bonds due to adverse developments in the credit markets led to the negative cost-of-carry. As shown in Table 9, the total interest expense paid from June 2006 through May 2008 exceeded by more than \$143 million the amounts earned on investments of the bond proceeds. After the auction market failed, Citizens established a strategy to exit the auction rate security market by buying back its auction rate securities in the auction market. Citizens' purchase of its auction rate securities during the period January 1, 2008, through March 1, 2008, is currently the subject of a Securities and Exchange Commission inquiry and an Office of Financial Regulation inquiry. Adverse effects, if any, related to these inquiries were unknown at the date of our audit report.

Table 9

Comparison of Bond Interest Expense and Earnings on Investment of Bond Proceeds					
From June 2006 through May 2008					
(In Millions)					
<u>Accounts</u>	<u>Interest Earnings</u>	<u>Interest Expense</u>	<u>Cost-of-Carry, Before Realized and Unrealized Losses</u>	<u>Net Realized and Unrealized Losses</u>	<u>Total Cost-of-Carry</u>
HRA Senior Secured Bonds, Series 2006A	\$ 287	\$ 305	\$ (18)	\$ (97)	\$ (115)
PLA Senior Secured Bonds, Series 2007A	35	41	(6)	(22)	(28)
Totals	\$ 322	\$ 346	\$ (24)	\$ (119)	\$ (143)

Source: Citizens Investment Earnings and Interest Expense Reports

⁵ Auction rate bonds are generally long-term bonds that have interest rates that are reset at frequent intervals through auctions which typically occur every 7, 14, 28 or 35 days. Bids with the lowest interest rates get accepted first, followed by successively higher bids until all bonds available for auction are sold. The highest rate accepted in the auction then becomes the interest rate that applies to all the bonds until the next auction. When there are not sufficient bids to purchase all the bonds, the auction fails and the holders of the bonds will generally receive an interest rate set above market rates for the next auction period. The bond offering documents identify how rates will be calculated when auctions fail.

- In audit report No. 2006-096, finding No. 17, Financing Options, we recommended that for the FWUA Series 1999A bonds, Citizens continue the exploration of means by which the differential between interest expense and investment earnings may be reduced. Citizens refunded the FWUA Series 1999A bonds during February 2007 which resulted in an approximate \$276.9 million gross cash flow savings and a \$86.5 million present value cash flow savings. Additionally, the call premium which was estimated at \$245 million in September 2004 was reduced to \$181 million at the time of the refunding.

Recommendation: We recommend that Citizens continue its efforts to reduce the cost-of-carry on any pre-event financing while maintaining the safety and liquidity of the financing proceeds through conservative investment. Furthermore, we recommend that Citizens continue to monitor its investments for compliance with its investment policy.

PRIOR AUDIT FOLLOW-UP

As part of our audit, we determined that Citizens staff had corrected, or were in the process of correcting, the applicable findings included in audit report No. 2006-096, unless otherwise noted above.

OBJECTIVES, SCOPE, AND METHODOLOGY

The Auditor General conducts operational audits of governmental entities to provide the Legislature, Florida's citizens, public entity management, and other stakeholders unbiased, timely, and relevant information for use in promoting government accountability and stewardship and improving government operations.

We conducted this operational audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

This operational audit focused on information technology (IT) controls, other selected internal controls, internal audit function establishment, procurement, personnel administration, customer service, claims handling, take-out programs and bonuses, policyholder eligibility, and financing arrangements. Our audit covered the period March 2006 through February 2008, and selected actions through December 16, 2008. The overall objectives of the audit were:

- To evaluate the effectiveness of established internal controls in achieving management's control objectives in the categories of compliance with controlling laws, administrative rules, and other guidelines; the economic, efficient, and effective operation of State government; the validity and reliability of records and reports; and the safeguarding of assets.
- To evaluate management's performance in achieving compliance with controlling laws, administrative rules, and other guidelines; the economic, efficient, and effective operation of State government; the validity and reliability of records and reports; and the safeguarding of assets.
- To determine whether the management has corrected, or is in the process of correcting, deficiencies disclosed in the prior audit (report No. 2006-096).
- 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, and legislative staff.
- 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, daily and catastrophe claim file documentation.

AUTHORITY

Section 627.351(6)(l), Florida Statutes, requires that the Auditor General conduct an operational audit of Citizens Property Insurance Corporation every three years. 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.



David W. Martin, CPA
Auditor General

MANAGEMENT'S RESPONSE

In a response letter dated January 22, 2009, the President and Executive Director of Citizens Property Insurance Corporation concurred with our audit findings and recommendations. The President's response is included as Exhibit A.

**EXHIBIT A
MANAGEMENT'S RESPONSE**

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



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David W. Martin, CPA, Auditor General
State of Florida
G74 Claude Pepper Building
111 West Madison Street
Tallahassee, FL 32399-1450

January 22, 2009

Dear Mr. Martin:

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 23, 2008. We were pleased to find that your report recognized the steps Citizens has taken to improve customer service, including but not limited to, the establishment of a Consumer Services Department and a Consumer Services Committee, web site enhancements, and policyholder forums held throughout Florida. We were also encouraged that your evaluation of our surveys indicated that most agents were satisfied with Citizens' operations and overall support, including its training program and electronic policy administration systems.

This Operational Audit for the period March 1, 2006 through February 29, 2008 provides an opportunity for improvement and we will use the report findings to continue to enhance our infrastructure, processes and procedures.

Please let me know when the final Audit Report will be released.

Sincerely,

A handwritten signature in black ink that reads "Scott Wallace".

Scott Wallace
President/CEO and Executive Director

SW/bw
Enclosure

cc: James Malone, Chairman
Joyce Bellows, Chief of Internal Audit

James R. Malone, Chairman, Collier County
Jay Odom, Okaloosa County • Earl Horton, Pinellas County • Carol Everhart, Pinellas County
Allan Katz, Leon County • Carlos Lacasa, Hillsborough County • Sherrill W. Hudson, Miami-Dade County
William P. Cory, Indian River County • Scott Wallace, President/CEO & Executive Director

EXHIBIT A
MANAGEMENT'S RESPONSE (CONTINUED)

CITIZENS PROPERTY INSURANCE CORPORATION
MANAGEMENT RESPONSES TO PRELIMINARY AND TENTATIVE
AUDIT FINDINGS

Finding No. 1 – Enterprise Risk Management

In Audit Report No. 2006-096, we noted that Citizens had no documentation to support that it had conducted an enterprise-wide evaluation of the effectiveness of operational and financial controls. Similarly, our current audit disclosed that no such evaluation had been completed during the audit period. However, on October 23, 2008, Citizens management presented to the Board a proposal to create an Enterprise Risk Management function that at a minimum will encompass risk management, compliance, and quality assurance.

Recommendation: We recommend that Citizens continue its implementation of an enterprise risk management function.

Management Response:

Citizens agrees with the Auditor General recommendation. In 2009, we will create an Enterprise Risk Management (ERM) function at Citizens that will increase our ability to better determine financial risks, implement strong enterprise-wide controls and more effectively identify and manage risks across the corporation.

Finding No. 2 – Conflict of Interest Disclosure Forms

Citizens' records in some instances did not contain a completed and signed Conflict of Interest Disclosure Form to evidence that the Citizens employees taking part in the evaluation and contract award processes were independent of, and had no conflict of interest with respect to, the vendors evaluated and selected. Additionally, we determined that in some instances, Citizens did not timely receive Conflict of Interest Disclosure Forms executed by the vendors.

Recommendation: We recommend that Citizens ensure that employee and vendor conflict of interest statements are timely obtained and retained in Citizens' records.

Management Response:

We agree with this overall recommendation and have already implemented procedures to assure that employee and vendor conflict of interest statements are timely obtained and retained in Citizens' records.

Finding No. 3 – Information Technology Security Awareness Program

Citizens had not established an information technology security awareness program. The purpose of a security awareness program is to inform personnel of the importance of the information they handle and the legal and business reasons for maintaining its integrity, confidentiality, and availability.

Recommendation: We recommend that Citizens continue in its efforts to implement a security awareness program.

EXHIBIT A
MANAGEMENT'S RESPONSE (CONTINUED)

Management Response:

We agree with the recommendation. An Information Technology Security Awareness Program is planned to be delivered to the Citizens' employees through a vendor prepared program.

Finding No. 4 – Information Technology Security Controls

Effective security controls include access controls that ensure that users have only the access privileges needed to perform their duties, access to sensitive resources is limited to only a few users, and users are restricted from performing incompatible functions. Our audit disclosed deficiencies in certain security controls.

Recommendation: We recommend that Citizens ensure that user access authorization documentation is appropriately maintained. We also recommend Citizens perform periodic reviews of access privileges to ensure that the access granted is appropriate and monitor compliance with procedures requiring the timely revocation of the access privileges of terminating employees and contractors.

Management Response:

We agree with the recommendation. We plan to implement the following control enhancements: 1) Account Management Recertification; 2) Implementation of Active Directory automatic provisioning/de-provisioning user rights tools; 3) additional review and challenge of aged accounts; and 4) transfer of certain access control functions to the Information Security Office.

Finding No. 5 – Other Security Controls

We noted certain other deficiencies in Citizens' security control features, the details of which have been disclosed to appropriate members of Citizens management.

Recommendation: We recommend that Citizens implement the appropriate security controls to ensure the confidentiality, integrity, and availability of data and IT resources.

Management Response:

We agree with this recommendation. Citizens is in the process of implementation of a specific solution for the enforcement of required controls for the specific system as noted in the AG's recommendation

Finding No. 6 – Internal Audit Procedures

Policies and procedures providing guidance for the internal audit activity had not been completed. The objective of such policies and procedures is to provide for the internal audit function an operational framework which reasonably ensures auditor compliance with governing auditing standards.

Recommendation: Citizens should continue its efforts to develop policies and procedures necessary to guide the internal audit activity and ensure compliance with IIA standards.

EXHIBIT A
MANAGEMENT'S RESPONSE (CONTINUED)

Management Response:

We agree with this recommendation. Comprehensive OIA department policies and procedures have been targeted for completion by the 1st quarter of 2010. As required by the IIA Standards, the OIA will engage an outside firm to conduct the required Quality Assurance Review of the Citizens OIA department no later than June 2010.

Finding No. 7 – Take-Out Program Long Term Monitoring

Section 627.351(6), Florida Statutes, as amended, required that effective July 1, 2007, in order to evaluate the costs and benefits of approved take-out plans, if Citizens pays a bonus or other payment to an insurer for an approved take-out plan, then Citizens shall maintain a record of all addresses or such other identifying information on the property or risk removed in order to track if and when the property or risk is later insured by the corporation. To address the requirements of the statute, Citizens developed a software application (application) to identify policies that may be returning to Citizens after having been assumed by a take-out insurer. The application was run monthly beginning in October 2007. However, the output from the application has not been reviewed by Citizens staff to determine what policies may be returning to Citizens from take-out insurers.

Recommendation: We recommend that Citizens perform long-term monitoring on the take-out programs by reviewing the application output to identify policies returning to Citizens from take-out insurers, follow-up on why the policies are returning, and develop strategies to strengthen current take-out programs.

Management Response:

We agree in part with this recommendation; however it ignores the language of current law which does not require that Citizens identify and track all policies which have ever been assumed to determine if they return to Citizens. Rather, the statute only requires, effective July 1, 2007, that Citizens track those policies which are assumed and for which a takeout bonus was paid. Because the currently approved takeout programs do not provide for the payment of a bonus, the 400,000 policies removed from Citizens in 2008 and many of those assumed in 2007 are not subject to this statutory monitoring requirement.

Additionally, under current law, even policies which have been removed from Citizens can qualify for coverage with Citizens and return to Citizens, whether a bonus is paid or not, if the premium charged by the takeout insurer is more than 15% higher than the Citizens rate for comparable coverage.

Notwithstanding the foregoing, for those policies assumed after July 1, 2007 which qualify for the payment of a bonus, Citizens will utilize its monthly reports of policies that were assumed and return as new business and update internal processes to incorporate the data analysis of these reports and provide management with their findings.

EXHIBIT A
MANAGEMENT'S RESPONSE (CONTINUED)

Finding No. 8 – Policyholder Notification

Insurers which were interested in considering the take-out policies were to request from Citizens a selection file. In response to the request for a selection file, Citizens provided a data file to prospective take-out insurer of all policies eligible for take-out. However, prior to March 11, 2008, when the selection file was provided, Citizens also communicated to the prospective take-out insurer that the policies written by certain insurance agencies or captive agents should not be selected, as the agencies or agents would be unable or unwilling to be appointed as an agent of the prospective take-out insurer and, thus, may not present a take-out proposal to the policyholder. Effective March 2008, Citizens was required by consent order of the Office of Insurance Regulation, to send notice to any policyholder whose policy has been selected for take-out, but whose agent is unable or unwilling to be appointed by the take-out insurer, that an offer of coverage was made which may have saved them premium dollars.

Recommendation: We recommend that in administering its responsibilities under the take-out programs, Citizens comply with the consent order.

Management Response:

We agree with this recommendation. Citizens has and will continue to work very closely with the Office to facilitate the removal of policies from the corporation and to promote the success of the takeout programs. We pledge our continued commitment to these programs and are unaware of any failure to comply with the requirements of Consent Order 94539-08.

Finding No. 9 – Market Assistance Plan

Section 627.3515, Florida Statutes, 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. Section 627.3515(3)(a), Florida Statutes, as amended, also requires that the Plan and Citizens develop a business plan providing for the implementation of an electronic database for the purpose of confirming eligibility. Our audit disclosed:

- Additional opportunities to promote the Market Assistance Plan, and thereby increase its production of voluntary insurer placements, may exist through real estate professionals, mortgage companies and brokers, and others involved in the sale of real estate and the financing and refinancing thereof.
- The business plan was submitted to the Financial Services Commission, and in presenting the Plan, Citizens identified several potential implementation issues that required further consideration. As of December 16, 2008, further development of the proposed electronic database was pending.

Recommendation: We recommend that the Plan consider additional opportunities and methods that may be used to promote the use of the Plan. We also recommend that any obstacles to the development of the electronic eligibility database be presented to the Legislature for evaluation.

EXHIBIT A
MANAGEMENT'S RESPONSE (CONTINUED)

Management Response:

We agree, in part, with this recommendation. Citizens and FMAP are exploring a variety of ways to promote the use of the Plan, which can benefit hundreds of thousands of Floridians. We appreciate the implicit recognition in this report of the potential that a robust, fully effective Plan could achieve. However, with respect to the additional recommendation that we identify any obstacles to the development of an electronic eligibility database, we point out that such obstacles are discussed in the 2007 public report to the Financial Services Commission, which is available to the public, including members of the legislature.

Finding No. 10 – Managing Stakeholder Feedback

Citizens has taken steps to improve customer service, including but not limited to, the establishment of a Consumer Services Department and a Consumer Services Committee, Web site enhancements, and the conduct of policyholder forums. In evaluating customer service issues, we surveyed a sample of policyholders, analyzed complaint data maintained by the Department of Financial Services, and surveyed a sample of agents appointed by Citizens. The results of these surveys and analyses indicate that there remain opportunities for Citizens to further enhance customer service. One such opportunity involves the establishment of a central reporting mechanism to aggregate and evaluate customer service issues for Citizens as a whole.

Recommendation: Citizens should continue its efforts to implement a corporate-wide system that will facilitate the aggregation and evaluation of all customer service issues.

Management Response:

We agree with this recommendation and will continue our efforts to provide superior customer service at all levels throughout the corporation.

Finding No. 11 – Claim Adjustment and Payment

With respect to claims reviewed, we evaluated 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, and the sufficiency of the steps taken by Citizens to review the findings of the adjusters. Our audit disclosed that some improvements were needed. Specifically:

- In audit report No. 2006-096, we noted that in adjusting claims, Citizens was not enforcing the 80 percent co-insurance clause in its various insurance policies. Our current audit again found few insurance-to-value analyses in the claim files reviewed.
- For some of the claims reviewed, Citizens did not appear to have taken sufficient action to subrogate claims.

Recommendation: We recommend that Citizens complete insurance-to-value analyses and, when necessary and appropriate, enforce the 80 percent co-insurance policy clauses. We also recommend that citizens pursue subrogation of losses when appropriate. In

EXHIBIT A
MANAGEMENT'S RESPONSE (CONTINUED)

those cases in which subrogation is available, but not pursued, we recommend that claims files contain notes explaining why subrogation was not pursued. Lastly, we recommend Citizens determine, where appropriate, that replacement items can be matched thereby reducing the amount of the claims adjusted.

Management Response:

We agree with this insurance-to value recommendation, which validates the insurance-to-value program we began in 2005. We also agree that subrogation should be pursued where appropriate. We agree that replacement items should be matched where appropriate, subject to the requirements of Section 626.9744(2).

Finding No. 12 – Mediation and Appraisal

Of the sixty reopened claims that we tested, we found that 28 went through mediation, appraisal, or lawsuit. For 26 of these 28 claims, a public adjuster had been hired by the policyholder. Our testing disclosed the following relating to the mediation and appraisal process:

- For 18 of the 28 reopened cases that went to mediation, appraisal, or umpire, either the public adjuster representing the policyholder or the public adjuster's firm performed the appraisal. This appears to be contrary to policy terms which require that appraisals be performed by a disinterested appraiser.
- There was no requirement that the umpires, in making award decisions, itemize or otherwise explain the rationale followed in determining the award, and in the files we reviewed; the umpire's award did not itemize the specific cost elements in the award or the rationale for the award.

Recommendation: We recommend that Citizens continue to evaluate its options relating to the handling of mediation, appraisal, and umpiring and select an option which ensures the fair treatment of policyholders and full disclosure of all decisions made relative to the claim amounts ultimately paid. Should appraisal be retained as an option, we recommend that Citizens amend its policy forms to include the criteria to be used by Citizens and the policyholders in determining that the appraisers selected are competent and disinterested.

Management Response:

We agree with this recommendation. Citizens is working to finalize proposed amendments to its policy forms for filing with the Office of Insurance Regulation this year, which will modify or eliminate appraisal of disputed property claims. Citizens concurs with the Auditor General's concerns that a conflict of interest may arise when the insured's public adjuster (or a member of its firm) serves as the insured's appraiser.

Finding No. 13 – Underwriting Files

Citizens' underwriters (internal and contracted) are required, at a minimum, to review the applications and supporting documentation and to make decisions concerning eligibility, insurability, and receipt of correct premium. Our tests of 30 applications, including policy renewals, disclosed in three applications issues that were not appropriately addressed.

EXHIBIT A
MANAGEMENT'S RESPONSE (CONTINUED)

Recommendation: We recommend that Citizens ensure that underwriters are properly approving policies for only insurable risks, at the correct values, and all documentation supporting discounts and credits is received and entered into the imaging system. We also recommend that Citizens review the transferred policies prior to any further renewals.

Management Response:

Citizens implemented processes to ensure that underwriters properly approve risks with acceptable documentation to support value, eligibility and discounts / credits. Citizens' underwriting staff is required to utilize updated checklists to assist them in thoroughly reviewing underwriting files. In addition, we have designed and implemented a quality assurance program that includes file review within the underwriting department and separately through an independent compliance unit housed in product development. The purpose of the quality review is to ensure compliance with file review procedures, documentation requirements and checklists. Citizens has also developed and implemented an ongoing review of renewal policies that focuses on the verification of characteristics such as claims history, construction type and discounts / credits.

Finding No. 14 – Financing Options

Citizens should continue its efforts to reduce the cost-of-carry on any pre-event financing while maintaining the safety and liquidity of the financing proceeds through conservative investment.

Recommendation: We recommend that Citizens continue its efforts to reduce the cost-of-carry on any pre-event financing while maintaining the safety and liquidity of the financing proceeds through conservative investment. Furthermore, we recommend that Citizens closely monitor its investments for compliance with its investment policy.

Management Response:

We agree with this recommendation.