

**STATE OF FLORIDA AUDITOR GENERAL**

Operational Audit

Report No. 2016-009  
August 2015

**CITIZENS PROPERTY INSURANCE  
CORPORATION**



Sherrill F. Norman, CPA  
Auditor General

## **Citizens Property Insurance Corporation Board of Governors**

Section 627.351(6)(c)4., Florida Statutes, provides that Citizens Property Insurance Corporation (Citizens) operate subject to the supervision and approval of a Board of Governors (Board). Members of the Citizens Board who served during the period March 2011 through August 2014 were:

Chris Gardner	Chair, From August 2013 Member, From August 2011
Carlos Lacasa	Chair, September 2011 through July 2013
James Malone	Chair, March 2011 through July 2011

Gary Aubuchon	From August 2013	Earl Horton	Through July 2011
Nancy Bailey	August 2011 through December 2012	Sherrill Hudson	Through July 2011
Bette Brown	From March 2014	Harold M. Knowles	Through July 2011
William Corry	Through July 2011	Tom Lynch	Through July 2014
Juan Cucoy	From April 2013	John Rollins	September 2011 through August 2013
Carol Everhart	Through July 2013	Freddie Schinz	From August 2013
Don Glisson	From April 2012	Rob Wallace	August 2011 through February 2012
Jim Henderson	From August 2014	John Wortman	From September 2011
James Holton	From January 2014		

## **President/Chief Executive Officer and Executive Director**

Pursuant to Section 627.351(6)(c)4.a., Florida Statutes, the Executive Director of Citizens is engaged by the Board, subject to confirmation by the Senate, and serves at the pleasure of the Board. For the period March 2011 through August 2014, the following individuals served as President/Chief Executive Officer and Executive Director:

Barry Gilway	From June 2012
Tom Grady, Interim	March 2012 to June 2012
Scott Wallace	To March 2012

The team leader was Clint C. Boutwell, CPA, and the audit was supervised by Allen G. Weiner, CPA. Please address inquiries regarding this report to Kathryn D. Walker, CPA, Audit Manager, by e-mail at [kathrynwalker@aud.state.fl.us](mailto:kathrynwalker@aud.state.fl.us) or by telephone at (850) 412-2781.

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# CITIZENS PROPERTY INSURANCE CORPORATION

## **SUMMARY**

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This operational audit of Citizens Property Insurance Corporation (Citizens) focused on claims handling, customer service, take-out programs and bonuses, underwriting and eligibility, financing agreements, procurement of goods and services, internal controls, and the internal audit function. The audit also included a follow-up on the findings noted in our report Nos. 2013-011 and 2015-017. Our audit disclosed the following:

### **Underwriting and Eligibility**

**Finding 1:** Citizens' controls did not always ensure that only eligible policies were issued or renewed.

**Finding 2:** As similarly noted in our report No. 2013-011, Citizens' controls did not always ensure that errors in applications for coverage were timely corrected.

### **Clearinghouse**

**Finding 3:** Clearinghouse system overrides of policy ineligibility determinations were not traceable to the responsible individual.

### **Customer Service**

**Finding 4:** Analysis of customer service data and surveys of policyholders and agents indicated that Citizens provided customer service comparable to the quality generally provided in the voluntary market.

### **Probable Maximum Loss Financing**

**Finding 5:** While Citizens had taken reasonable steps to minimize its net financing costs (cost-of-carry), it may be possible over time to further reduce these costs as, pursuant to State law,<sup>1</sup> the premiums collected become more consistent with those that would be calculated using actuarially determined rates.

### **Claims Handling**

**Finding 6:** Citizens did not always appropriately document that contracted adjusters were independent of, and had no conflict of interest in, the claims they were assigned to process.

### **Property Records and Inventories**

**Finding 7:** Controls over Citizens' property items need enhancement.

### **Information Technology Controls**

**Finding 8:** Certain security controls related to selected Citizens' IT systems continue to need improvement.

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<sup>1</sup> Section 627.351(6)(n), Florida Statutes.

## **BACKGROUND**

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State law<sup>2</sup> establishes Citizens Property Insurance Corporation (Citizens) to provide affordable residential and commercial property insurance to applicants who are in good faith entitled to procure insurance through the voluntary market but are unable to do so. Citizens is a governmental entity that is an integral part of the State and is not a private insurance company.

In accordance with State law,<sup>3</sup> Citizens operates subject to the supervision and approval of a nine-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. Additionally, the Governor is to appoint the ninth Board member who is to serve as a consumer advocate. The Executive Director of Citizens and senior managers are engaged by and serve at the pleasure of the Board and the Executive Director is responsible for employing other staff as Citizens may require, subject to review and concurrence by the Board.

State law<sup>4</sup> provides that all revenues, assets, liabilities, losses, and expenses of Citizens are to be divided into three separate accounts, as follows:

- *Personal lines account (PLA)* - for personal residential policies issued by Citizens. Such policies are to provide comprehensive, multiperil coverage on risks that are not located in areas eligible for coverage in the Florida Windstorm Underwriting Association (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.
- *Commercial lines account (CLA)* - for commercial residential and commercial nonresidential policies issued 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.
- *Coastal account* - for personal residential policies and commercial residential<sup>5</sup> and commercial nonresidential property policies issued by 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.

Table 1 provides a summary, by account, of Citizens' policies in force, the premiums with surcharges, and loss exposure, as of December 31, 2012, 2013, and 2014. As shown by Table 1, the number of policies in force decreased by approximately 654,000, or 50 percent, from December 31, 2012, to December 31, 2014.

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<sup>2</sup> Section 627.351(6), Florida Statutes.

<sup>3</sup> Section 627.351(6)(c)4., Florida Statutes.

<sup>4</sup> Section 627.351(6)(b)2., Florida Statutes.

<sup>5</sup> Section 627.351(6)(b)2., Florida Statutes, specified that effective July 1, 2014, Citizens was to cease offering new commercial residential policies providing multiperil coverage and instead was to continue to offer commercial residential wind-only policies. Citizens was permitted to offer commercial residential policies excluding wind and to continue to renew commercial residential multiperil policies on buildings that were insured by Citizens on June 30, 2014, under a multiperil policy.

**Table 1**  
**Summary of Citizens' Policies in Force, Premiums with Surcharges, and Loss Exposure**

As of December 31, 2012, 2013, and 2014

Account	Policies In Force	Premiums With Surcharges	Loss Exposure
December 31, 2012:			
Personal-Residential (PLA)	860,502	\$1,416,566,185	\$184,205,167,233
Commercial (CLA)	8,146	205,212,640	39,842,489,620
Coastal	446,163	1,199,099,562	205,376,742,277
<b>Totals</b>	<b><u>1,314,811</u></b>	<b><u>\$2,820,878,387</u></b>	<b><u>\$429,424,399,130</u></b>
December 31, 2013:			
Personal-Residential (PLA)	627,391	\$1,015,161,890	\$115,420,299,059
Commercial (CLA)	7,615	198,093,517	37,080,526,066
Coastal	386,688	1,079,109,126	166,386,660,419
<b>Totals</b>	<b><u>1,021,694</u></b>	<b><u>\$2,292,364,533</u></b>	<b><u>\$318,887,485,544</u></b>
December 31, 2014:			
Personal-Residential (PLA)	373,617	\$ 595,777,286	\$ 66,059,640,393
Commercial (CLA)	4,681	99,866,987	20,282,397,134
Coastal	282,863	759,847,325	115,615,358,798
<b>Totals</b>	<b><u>661,161</u></b>	<b><u>\$1,455,491,598</u></b>	<b><u>\$201,957,396,325</u></b>

Source: Citizens' records.

Pursuant to State law,<sup>6</sup> to reduce the number of policies in force and Citizens' exposure to loss, authorized insurers may take policies out from Citizens. Table 2 summarizes the policies taken out from Citizens during the 2012 through 2014 calendar years.

**Table 2**  
**Citizens' Policy Take-Outs**

For the 2012 Through 2014 Calendar Years

Calendar Year	<u>PLA</u>		<u>Commercial and Coastal</u>		<u>Total</u>	
	Number of Policies	Exposure (000's)	Number of Policies	Exposure (000's)	Number of Policies	Exposure (000's)
2012	252,968	\$ 70,199,355	24,034	\$ 5,727,810	277,002	\$ 75,927,165
2013 <sup>a</sup>	301,383	76,337,080	64,384	35,928,330	365,767	112,265,410
2014	323,167	66,688,740	93,456	50,841,343	416,623	117,530,083
<b>Totals</b>	<b><u>877,518</u></b>	<b><u>\$213,225,175</u></b>	<b><u>181,874</u></b>	<b><u>\$92,497,483</u></b>	<b><u>1,059,392</u></b>	<b><u>\$305,722,658</u></b>

<sup>a</sup> Approximately 71,000 policies and \$36.5 billion in total exposure were removed by two quota share reinsurance contracts.

Source: Citizens' records.

<sup>6</sup> Sections 627.351(6)(q)3.a., and 627.3511, Florida Statutes.

In general, the premium due from a Citizens' policyholder is derived by applying a standard calculation including applicable factors obtained from standard manuals, depending on the type and amount of coverage, and then reducing the result by any eligible discounts, for example, wind mitigation credits. Pursuant to State law,<sup>7</sup> beginning on or after January 1, 2010, nonsinkhole premium rates were limited to 10 percent annual increases, even if the application of actuarially determined rates indicated larger increases.

As shown in Table 3, Citizens' actuarial estimates depicted a difference of approximately \$1.96 billion between the premiums that would have been due using actuarially determined rates and the premiums actually authorized for the 2012 through 2014 calendar years.<sup>8</sup>

**Table 3**  
**Premiums Foregone Due to Capping**  
**(In Millions)**

Calendar Year	PLA/CLA	Coastal	Total
2012	\$ 482	\$441	\$924
2013	207	558	765
2014	35	235	270
<b>Totals</b>	<b><u>\$724</u></b>	<b><u>\$1,234</u></b>	<b><u>\$1,959</u></b>

Source: Actuarial estimates provided by Citizens' Chief Actuary.

State law<sup>9</sup> requires the Auditor General to conduct an operational audit of Citizens every 3 years. The scope of the audit is to include, but not be limited to, claims handling, customer service, take-out programs and bonuses, financing arrangements, procurement of goods and services, internal controls, and the internal audit function. Our findings are described in this report under the heading **FINDINGS AND RECOMMENDATIONS** and a detailed description of the audit work performed is included under the heading **OBJECTIVES, SCOPE, AND METHODOLOGY**.

<sup>7</sup> Section 627.351(6)(n)6., Florida Statutes.

<sup>8</sup> In providing these estimates, Citizens assumed that policy counts would remain constant, but indicated that had actuarially determined rates been used during the 2012 through 2014 calendar years, some policyholders may have obtained insurance in the private (voluntary) market, thus reducing the premiums foregone estimated. However, Citizens had not estimated how many policyholders may have gone into the private market or how much the estimated foregone premiums would have been reduced.

<sup>9</sup> Section 627.351(6)(m), Florida Statutes.

## **FINDINGS AND RECOMMENDATIONS**

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### **UNDERWRITING AND ELIGIBILITY**

Citizens provides coverage for dwellings, other structures, personal property (contents), rentals and additional living expenses, and has developed underwriting guidelines for each line of business for use by agents and underwriting personnel when preparing and reviewing applications for coverage. To ensure applications provide consistent, complete, and accurate information to base eligibility and underwriting decisions on, the Citizens' Agent Appointment Agreement requires that agents, in accordance with the procedures established by Citizens, be responsible for assuring that all submitted applications are complete and accurate and in compliance with pertinent application requirements for the requested coverage.

Citizens' underwriters<sup>10</sup> (internal and contracted) were required, at a minimum, to review the applications and supporting documentation and to make decisions concerning eligibility, insurability, and the assessment of the correct premium. Citizens had established a quality assurance function whereby a team of experienced underwriters was to review internal underwriters' work each month on a sample basis. The underwriting quality assurance reviewers were dedicated to either commercial or personal lines and provided regular performance reports to Citizens' management that identified error rates and trends. Contracted underwriters were required to perform similar quality assurance reviews and provide regular quality assurance reports to Citizens. Our examination of Citizens' underwriting controls and records identified opportunities for improvement as described in Findings 1 and 2.

#### **Finding 1: New and Renewed Policy Coverage Limits**

Pursuant to State law,<sup>11</sup> effective January 1, 2014, structures with a dwelling replacement cost or Coverage A<sup>12</sup> of \$1,000,000 or more, or single condominium units with combined dwelling and contents replacement costs of \$1,000,000 or more are not eligible for coverage by Citizens. Any such dwellings insured by Citizens as of December 31, 2013, were permitted to remain covered until the end of the policy term. Citizens must complete the nonrenewal procedures in sufficient time to comply with statutorily required nonrenewal notice periods<sup>13</sup> to first-named insureds.

To ensure compliance with the statutory coverage restrictions, Citizens' management stated in response to our audit inquiry that Citizens updated pertinent policy manuals to alert underwriters of the restrictions, obtained approval for the policy manual changes from the Office of Insurance Regulation (OIR), and initiated programming changes to applicable policy systems to automatically reject new applications that were ineligible under the new statutory provisions.

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<sup>10</sup> Insurance underwriters evaluate applications and determine whether to provide insurance, terms of insurance, and the appropriate coverage amounts and premiums.

<sup>11</sup> Section 627.351(6)(a)3.a., Florida Statutes.

<sup>12</sup> Citizens' Coverage A is for the replacement cost of the insured dwelling. Contents coverage (Coverage C) must be purchased separately.

<sup>13</sup> Pursuant to Section 627.4133(1)(a), Florida Statutes, property insurers are required to provide insureds at least 45 days advance written notice of nonrenewal.

As part of our audit, we analyzed data related to Citizens' personal lines policies that were newly written or renewed during the period January 1, 2014, through August 31, 2014, to determine whether Citizens wrote or renewed personal line policies that equaled or exceeded the \$1,000,000 threshold for dwelling coverage or dwelling and contents coverage for condominiums. Our audit procedures disclosed that 439 of the 658,785 personal lines policies written or renewed during the period January 1, 2014, through August 31, 2014, exceeded the statutory threshold of \$1,000,000. Specifically:

- 298 personal policies with dwelling coverage ranging from \$1,000,000 to \$1,035,700 (and totaling \$301,952,100) were inappropriately renewed.
- 126 wind-only policies for condominiums with combined dwelling and contents coverage ranging from \$1,000,000 to \$2,650,000 (and totaling \$167,635,090) were inappropriately renewed.
- 14 new personal policies with dwelling coverage of \$1,000,000 each (and totaling \$14,000,000) were inappropriately written.
- One new wind-only condominium policy with combined dwelling and contents coverage totaling \$1,000,000 was inappropriately written.

In response to our audit inquiry, Citizens' management indicated that some of these policies had been evaluated at less than \$1,000,000 prior to January 1, 2014, and identified for renewal since they did not exceed the statutory threshold; however, the annual inflation adjustment increased the dwelling coverage to over \$1,000,000 at the policies' renewal dates in 2014. Citizens' management acknowledged that other policies exceeding \$1,000,000 had been mistakenly renewed during 2014 due to a policy system error. Additionally, Citizens' management stated the new policies issued with Coverage A (dwelling) amounts totaling \$1,000,000 were the result of a coding error. The coding error was later discovered and, according to Citizens' management, corrected, and the applicable policies were manually set for nonrenewal.

Effective procedures to reject new policy applications or renewals in excess of statutory coverage limits would provide greater assurance that only those policies eligible for coverage are being insured by Citizens.

**Recommendation: We recommend Citizens' management enhance procedures for complying with statutory coverage limits.**

## **Finding 2: Underwriting Controls**

Citizens' personal lines underwriting procedures provided guidance to underwriters when validating Coverage A amounts during the underwriting review process. The Coverage A amount was to be used to calculate the policyholder's insurance premium. The procedures required that:

- Agents accurately complete the Citizens' Replacement Cost Estimator (RCE) for the dwelling;
- Each dwelling be insured at its full replacement cost;
- The policy limit for the Coverage A insured value be no less than 100 percent and no greater than 125 percent of the full replacement cost as determined by the RCE; and,
- An underwriter adjust the Coverage A amount if the underwriter noted discrepancies with the RCE and the underwriter's recalculated estimate of the cost to replace the dwelling was 10 percent more or less than the requested Coverage A amount.

To validate the requested Coverage A amount, the procedures required underwriters to compare the completed RCE with exterior photos, inspection photos, and specified records of the dwelling, and any alternative valuation method, if provided. Our examination of 32 applications for personal lines policies selected from the 137,943 applicable<sup>14</sup> personal lines policies accepted for coverage by Citizens during the period September 1, 2013, through August 31, 2014, disclosed that 7 applications (22 percent) contained discrepancies that affected the calculation of the RCE. Specifically:

- The roof shape used to calculate the RCE for two applications did not agree with the supporting photos and other documents. A gable roof, instead of the actual hip roof, was used in the RCE calculation for one application while a hip roof, instead of the actual gable roof, was used in the RCE calculation for the other application. For another two applications, the square footage of the attached structures was understated and did not include an open porch. While the RCE recalculated by Citizens for all four applications was within the 10 percent RCE error limit and no adjustment was required pursuant to Citizens' underwriting procedures, the presence of undetected errors increases the risk that inappropriate underwriting decisions and premium determinations may be made and not appropriately corrected.
- Citizens' underwriters identified an error in the roof type for one application but did not adjust the Coverage A amount as the error in the RCE was less than 10 percent. However, as the policy was a modified homeowner's policy, the 10 percent variance was not applicable. As a result of the error, the Coverage A amount was understated by \$7,000.
- For one application, the attached structures did not include the dwelling's enclosed porch. The recalculated RCE was 10.4 percent greater than the Coverage A amount, thus requiring a change in the Coverage A amount. However, because the error was not caught during the application review process, no change was made to the policy's Coverage A amount.<sup>15</sup>
- The original RCE estimate for one application totaled \$115,000 and the Coverage A amount totaled \$120,000. Citizens identified several errors in the RCE during the application review process and a revised RCE estimate of \$157,000 was calculated by Citizens' underwriters. The application was subsequently resubmitted and the policy was issued with a Coverage A amount totaling \$157,000. Citizens then recalculated the RCE estimate and determined the appropriate Coverage A amount should be \$144,000 and notified the agent to request the policyholder decrease their Coverage A amount to \$144,000.

To help ensure the accuracy of Coverage A amounts, Citizens developed a standard tool for estimating dwelling replacement costs and established multiple levels of review and approval for applications, including a quality assurance function to periodically review and report on the work of underwriters. However, the frequency of application and RCE errors indicates that the controls were not always effective. Absent detection of errors in policy applications, the RCE, and Coverage A amounts, incorrect underwriting decisions and premium calculations may be made and escape timely correction. A similar finding was noted in our report No. 2013-011, finding No. 1.

**Recommendation: We recommend that Citizens' management continue to enhance controls for the review and approval of applications for coverage and, as applicable, correct identified errors prior to approving applications for coverage.**

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<sup>14</sup> Agents were not required to complete an RCE for homeowner policies covering condominiums (HO-6 and HW-6 policies). Consequently, these policies were excluded from our examination.

<sup>15</sup> The Coverage A and premium for this policy were assumed by another carrier prior to the date of renewal.

State law<sup>16</sup> required Citizens to establish, by January 1, 2014, a clearinghouse program (Clearinghouse) to confirm new applicant eligibility for personal residential policy coverage through Citizens and enhance applicant and existing policyholder access to offers of coverage from other authorized insurers. Additionally, Citizens was required to develop procedures for diverting ineligible applicants and existing policyholders for commercial residential coverage into the private market and report by January 1, 2014, such procedures to the President of the Senate and the Speaker of the House of Representatives. To facilitate offers of coverage from authorized insurers and achieve diversion to the private market, Citizens was allowed to require all new applications and policy renewals for personal residential coverage be submitted to the Clearinghouse before approving or renewing coverage. Applicants for new coverage were to be deemed ineligible for coverage by Citizens if they received from an authorized insurer an offer for comparable coverage that was less than 15 percent greater than the premium quoted by Citizens. Policyholders renewing their policy were not eligible for coverage by Citizens if they received an offer for comparable coverage with a premium equal to or less than Citizens.

On August 22, 2013, the Citizens' Board approved a 5-year contract, with a 5-year renewal option, with a vendor<sup>17</sup> for clearinghouse services for an amount not to exceed \$44,500,000, primarily based on the number of transactions processed through the Clearinghouse. The vendor was to provide and service a single-entry, multiple-carrier interface software solution for the Clearinghouse.

The contract required system acceptance testing (SAT) to be completed prior to January 1, 2014, and detailed the process for formal acceptance of the testing after 45 consecutive business days of error-free operations following the SAT date. Recognizing the difficulties involved in programming multiple carriers' underwriting criteria to match their own, the differences involved in each product line, and programming the renewals of each product line, Citizens approved two contract amendments that adopted a phased implementation approach to include separate processing of policy renewals and SAT associated with each phase. Additionally, the amendments revised the completion date for the Clearinghouse SAT to March 1, 2015.

Citizens began processing applications for new HO-3 policies<sup>18</sup> through the Clearinghouse on January 27, 2014, and renewals of HO-3 policies on September 2, 2014. Citizens elected to process HO-3 application policies first as these policies accounted for the greatest number of policies and represented approximately 40 percent of all new applications as of November 2013. Table 4 summarizes the number of HO-3 applicants, eligible policies, ineligible policies, and the number of ineligible policies as a percentage of the total number of applicants. As of April 27, 2015, only applications and renewals for HO-3 and DP<sup>19</sup> policies were being processed through the Clearinghouse.

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<sup>16</sup> Section 627.3518, Florida Statutes.

<sup>17</sup> BOLT Solutions Inc., New York, New York.

<sup>18</sup> An HO-3 (Homeowners) policy is a Citizens' personal residential multiperil policy that provides the owner of an owner-occupied home with building, other structures, contents, additional living expense, and liability coverage.

<sup>19</sup> DP-3 (Dwelling Fire) policies provide the owner of a home, condominium or rental property with coverage for the dwelling, other structures, contents and loss of rent or additional living expenses. Tenant or renter's contents coverage can be provided as well. Premises liability coverage is optional. The homes covered by this policy are typically tenant occupied. A DP-1 policy is very similar, but with fewer perils covered and at a reduced cost.

**Table 4  
Summary of Clearinghouse Activity**

<b>HO-3 Transactions</b>	<b>Time Period</b>	<b>All Applicants</b>	<b>Eligible Policies</b>	<b>Ineligible Policies</b>	<b>Ineligible Policies as a Percentage of All Applicants</b>
New Policies	January 27, 2014, through January 15, 2015	161,818	138,870	22,948	14%
Renewals	September 2, 2014, through January 17, 2015	70,011	69,219	792	1%

Source: Citizens' Clearinghouse records.

On December 30, 2013, Citizens provided its statutorily required report to the President of the Senate and the Speaker of the House of Representatives detailing recommendations Citizens considered necessary for diverting ineligible applicants and existing policyholders for commercial residential coverage into the private market. Citizens' recommendations included: obtaining explicit legislative authority to expand the Clearinghouse to include commercial residential risks, determining carrier interest in assuming Citizens' commercial residential risks, and developing a cost-effective combination of manual and automated procedures and systems for expanding the Clearinghouse to commercial residential risks.

**Finding 3: Audit Trails of Overrides in the Clearinghouse System**

Effective information technology (IT) controls ensure the confidentiality, integrity, and availability of data and are essential to the overall efficient management of IT resources. To ensure the validity of systems data, IT controls should ensure that all users and their activity on IT systems are uniquely identifiable, and cost-effective technical and procedural measures are deployed and kept current to establish user identification.

Citizens limits access to the Clearinghouse by assigning each user a unique login identification name and password, and limits the assignment of administrator roles with specified permissions. Submission of new applications for coverage to the Clearinghouse requires agents to access the system and complete standard forms that detail the applicant's risks, property, and coverage. After the agent submits the application, the Clearinghouse automatically submits the risk to participating carriers for consideration. All offers of coverage, including Citizens', are displayed on the screen, allowing the applicant to choose a carrier if a suitable offer of coverage is available, or obtain coverage from Citizens if determined eligible. Once the applicant has selected a quote, the agent is to accept the quote and be transferred to the applicable carrier's portal to complete the process. A similar process is used for policy renewals, whereby Citizens is to submit the policy to the Clearinghouse at least 60 days before the renewal date to allow agents and policyholders adequate time to review any available quotes if the policyholder is determined ineligible for coverage through Citizens.

Subsequent to the selection of a quote but prior to binding the policy for coverage, carriers may rescind their offer of coverage because of additional information obtained affecting the applicant's status with respect to the carrier's underwriting criteria. After the Clearinghouse began processing new applications on January 27, 2014, agents occasionally requested Citizens to override ineligibility determinations if the rescinded quote resulted in the application being determined ineligible for coverage by Citizens. On May 11, 2014, functionality was introduced to the Clearinghouse allowing the six users with an administrator role to override determinations of ineligibility.

Our audit procedures disclosed that during the period May 13, 2014, through March 24, 2015, 153 overrides of ineligibility determinations were executed within the Clearinghouse by users with an administrator role. However, we found that no record of the identity of the specific user who made each override was retained in the system.

Absent the ability to identify the specific user who performs an override of a determination of ineligibility, the assignment of responsibility for an override would be impeded. In response to our audit inquiry, Citizens' management stated that Citizens had worked with the Clearinghouse vendor to include functionality that would identify the user who performed an override and the necessary revisions were operational as of June 7, 2015.

**Recommendation: We recommend Citizens' management ensure that, for each Clearinghouse system override, the identity of the specific user performing the override is recorded in the Clearinghouse system.**

#### CUSTOMER SERVICE

State law<sup>20</sup> provides, in part, that it is the intent of the Legislature for Citizens to provide services to policyholders, applicants, and agents which is no less than the quality generally provided in the voluntary market. As part of our audit, we evaluated Citizens' customer service function by analyzing complaint and inquiry data maintained by the Department of Financial Services (DFS),<sup>21</sup> and surveying a sample of policyholders and a sample of agents appointed by Citizens. As described in Finding 4, the survey results indicated that, in general, most policyholders and agents were satisfied with the level of service and support provided by Citizens. Our analysis of complaint and inquiry data maintained by the DFS indicated that Citizens' complaint experience was similar to that of other large property and casualty insurers.

#### **Finding 4: Policyholder and Agent Satisfaction**

##### **Policyholder Surveys**

Citizens, like other insurance companies, provides a number of services that range 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 during November 2014 and January 2015 to 1,020 policyholders who had policies in effect at some point during the period September 2013 through August 2014, including 510 who had claims that were closed during that same period. Survey questions

<sup>20</sup> Section 627.351(6)(a)1., Florida Statutes.

<sup>21</sup> The Department of Financial Services, Division of Consumer Services, classifies all inquiries regarding a property insurance carrier it cannot answer as a complaint, and forwards the inquiry to the applicable carrier for disposition.

addressed satisfaction with services related to policy issuance and renewal, call center operations, and claims handling, as applicable. We also included questions to measure policyholder satisfaction with Citizens' customer service and the services provided by Citizens' agents, as well as the policyholders' overall satisfaction with their insurance policies. We received 202 policyholder responses to our survey. Our evaluation of the surveyed policyholders' responses, as summarized in Table 5, indicated that most policyholders were satisfied with the services received from Citizens and Citizens' agents.<sup>22</sup> Additionally, the 82 percent of policyholders who responded that they were satisfied to very satisfied with their Citizens' policies was comparable to the policyholder satisfaction percentages reported in our report Nos. 2013-011 (86 percent) and 2009-102 (82 percent).

**Table 5**  
**Citizens' Policyholder Survey Results**

	<u>Very Dissatisfied to Dissatisfied</u>		<u>Satisfied to Very Satisfied</u>		<u>Total Responses<sup>a</sup></u>
	<u>Number</u>	<u>Percentage</u>	<u>Number</u>	<u>Percentage</u>	
Policy Issuance and Coverage	23	12%	176	88%	199
Policy Renewal	13	8%	153	92%	166
Insurance Agent Satisfaction	17	9%	169	91%	186
<b>Overall Satisfaction with Citizens' Insurance Policy</b>	<b>34</b>	<b>18%</b>	<b>155</b>	<b>82%</b>	<b>189</b>

<sup>a</sup> Not all the 202 policyholders who responded to the survey provided responses to every question.

Source: Policyholder survey responses.

## **Complaints**

We analyzed DFS, Division of Consumer Services' complaints and inquiries data for the period January 2013 through June 2014 to identify any indications of significant customer service issues and compared, by company, the number of complaints to the quarterly average number of policies in force during the period January 2013 through June 2014.<sup>23</sup> As shown in Table 6, our analysis disclosed that Citizens ranked fourth among the top 11 residential, commercial, and other property and casualty insurers in the State in terms of the number of complaints as a percentage of the quarterly average number of policies in force.

<sup>22</sup> We did not include an evaluation for call center operations and claims handling customer service questions as we did not receive a sufficient number of responses to those survey questions.

<sup>23</sup> Due to the significant number of policies removed from Citizens through depopulation efforts during the period January 2013 through June 2014, the quarterly average number of policies in force was used for this analysis. The quarterly average number of policies was calculated by totaling the number of policies in force, as reported by the OIR, for each company for each quarter ended during the period December 31, 2012, through June 30, 2014, and then dividing by the applicable number of quarters (seven).

**Table 6**  
**Analysis of Complaints and the Quarterly**  
**Average Number of Policies in Force**  
**During the Period January 2013 Through June 2014**

Company Ranking	Company	Number of Complaints <sup>a</sup>	Quarterly Average Number of Policies in Force	Complaints as a Percentage of the Quarterly Average Number of Policies in Force
1	A	96	138,647	0.0692%
2	B	265	513,640	0.0516%
3	C	77	177,524	0.0434%
4	Citizens	393	1,108,958	0.0354%
5	D	52	168,653	0.0308%
6	E	42	149,684	0.0281%
7	F	32	146,537	0.0218%
8	G	36	172,668	0.0208%
9	H	18	119,763	0.0150%
10	I	17	124,895	0.0136%
11	J	7	130,311	0.0054%

<sup>a</sup> Closed complaints for which the company or agent position was upheld, complaints that did not include sufficient information, complaints that were withdrawn, and requests to the DFS for mediation or sinkhole evaluation services were excluded from each company's number of complaints.

Source: Auditor-prepared from data provided by the DFS and the OIR.

### **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 operation of Citizens that appointed agents have the necessary resources to cost-effectively serve policyholders. Such resources should include adequate training, policyholder information available electronically, and consistent support from Citizens' underwriting, claims, and other staff. To measure agent satisfaction with the resources made available by Citizens and to identify potential areas where Citizens could enhance its operations with respect to appointed agents, we mailed surveys during December 2014 to 744 appointed agents.<sup>24</sup> Survey questions were designed to gauge agent satisfaction with, among other things, Citizens' training program, its primary electronic policy administration systems (ePAS and eDOCS), the Clearinghouse, service provided by Citizens' staff, and overall satisfaction with Citizens' agent support efforts. We received 130 agent responses to our survey. Our evaluation of the survey responses, as summarized in Table 7, indicated that most agents were satisfied with Citizens' operations. Our report Nos. 2009-102 and 2013-011 disclosed similar levels of agent satisfaction except for service, which declined from 85 percent, as noted in our report No. 2013-011, to 65 percent. Comments from agents regarding service provided by Citizens' staff indicated that training and consistency of response by Citizens' staff were

<sup>24</sup> Surveys were sent to 744 of the 9,658 agents who held a Citizens appointment during the period January 2013 through August 2014.

issues. Additionally, the Clearinghouse, which was recently implemented for HO-3 policies, received a 60 percent satisfaction rating and the agents provided comments such as “cumbersome”, “time-consuming”, “confusing”, and “difficult” to describe the system.

**Table 7  
Citizens Appointed Agent Survey Results**

	<u>Very Dissatisfied to Dissatisfied</u>		<u>Satisfied to Very Satisfied</u>		<b>Total Number of Responses<sup>a</sup></b>
	<b>Number of Reponses</b>	<b>Percentage of Responses</b>	<b>Number of Responses</b>	<b>Percentage of Responses</b>	
Agency Certification Program	8	6%	122	94%	130
Training	9	7%	121	93%	130
ePAS	12	11%	99	89%	111
eDOCS	12	11%	97	89%	109
New Policy Issuance	23	18%	107	82%	130
Policy Renewal	10	8%	120	92%	130
Service	45	35%	85	65%	130
Agent Appointment System	6	5%	124	95%	130
Claims Handling	2	2%	128	98%	130
Clearinghouse	40	40%	60	60%	100
<b>Overall Agency Support</b>	<b>10</b>	<b>8%</b>	<b>120</b>	<b>92%</b>	<b>130</b>

<sup>a</sup> Not all the 130 appointed agents who responded to the survey provided responses to every question.

Source: Appointed agent survey responses.

**Recommendation: We recommend that Citizens’ management continue efforts to provide quality customer service.**

**PROBABLE MAXIMUM LOSS FINANCING**

Citizens is responsible for ensuring that sufficient resources exist to pay no less than the probable maximum loss (PML) associated with a 1-in-100 year storm (100-year PML).<sup>25</sup> In meeting this responsibility, Citizens utilized catastrophe 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-Residential (PLA) and Commercial (CLA) accounts, and one for the risks accounted for within the Coastal account. For the 2014 hurricane season,<sup>26</sup> the estimated 100-year PMLs for the Coastal and PLA/CLA accounts were \$11.2 billion and \$4.9 billion, respectively.

To fund the payment of the 100-year PMLs, State law<sup>27</sup> authorizes Citizens to secure the necessary resources from the following sources:

- Available cash on hand from operations and bond financing (surplus).
- Proceeds from policyholder surcharges.

<sup>25</sup> A 1-in-100 year storm is defined as a storm having a 1 percent (1/100) chance of occurrence in any year.

<sup>26</sup> The National Hurricane Center defines the Atlantic hurricane season as beginning June 1<sup>st</sup> and ending November 30<sup>th</sup>.

<sup>27</sup> Section 627.351(6), Florida Statutes.

- Proceeds from regular and emergency assessments.
- Private market reinsurance.
- Reinsurance from the Florida Hurricane Catastrophe Fund (FHCF).
- Borrowed funds, such as, those provided through lines of credit and bond issues.

At the June 2014 Board meeting, Citizens' management provided an estimate of a surplus of approximately \$3.4 billion to pay claims for the Coastal account, which represented approximately 30 percent of the 100-year PML. Available FHCF reimbursements were reported as \$2.9 billion.

Additionally, at the June 2014 Board meeting, Citizens' management provided an estimate of a surplus of approximately \$4.1 billion available to pay claims for the PLA/CLA accounts, which represented approximately 83 percent of the 100-year PML. According to Citizens' estimates, this surplus would provide sufficient liquid resources to pay claims until FHCF reimbursements (approximately \$1.7 billion) became available, and provide additional claims paying resources for additional storms, loss adjustment expenses, or an event with losses in excess of those for a 1-in-100 year storm.

Claims in excess of available surplus and FHCF reinsurance would be covered through traditional private reinsurance, catastrophe bonds reinsurance, policyholder surcharges, and assessments. In the event of a 1-in-100 year storm, as of June 2014, the amounts that would be required from such sources were estimated to be approximately \$5 billion for Coastal account claims and \$0 for PLA/CLA accounts claims.

#### **Finding 5: Liquidity Financing**

In order to have sufficient cash on hand to pay catastrophic losses, Citizens provided for liquidity through the issuance of pre-event bonds (bonds issued in anticipation of storm events). Because cash must be readily available to pay claims, a primary goal must be the maintenance of the safety and liquidity of the bond proceeds through conservative investment. However, there is also a need to minimize the net financing 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.

As part of our audit, we evaluated 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. We found that Citizens had issued pre-event debt and paid issuance costs at rates not considered to be excessive and had earnings that appeared reasonable based upon the safety and liquidity criteria in its investment policy. During the period January 2012 through November 2014, the cost of providing additional liquidity of \$3.9 billion (amount of pre-event liquidity bonds outstanding at November 30, 2014) to pay potential claims in the event of a catastrophic event was approximately \$368 million as shown in Table 8.

**Table 8**  
**Bond Interest Expense and Earnings on Investment of Bond Proceeds**  
**January 2012 Through November 2014**

Bond Issue	Par Value of Bonds	Par Value of Bonds at November 30, 2014	Interest Expense	Interest Earnings	Issuance Costs and Underwriters Discount	Cost-of-Carry <sup>b</sup>
Coastal 2009A <sup>a</sup>	\$1,646,000,000	\$ 746,585,000	\$143,248,042	\$ 33,702,868	\$ -	\$(109,545,174)
Coastal 2010A <sup>a</sup>	2,400,000,000	1,240,000,000	177,002,967	58,672,674	-	(118,330,293)
Coastal 2011A <sup>a</sup>	900,000,000	645,000,000	85,801,013	23,138,578	-	(62,662,435)
PLA/CLA 2012A	1,500,000,000	1,300,000,000	95,918,556	26,256,252	8,405,108	(78,067,412)
<b>Totals</b>	<b><u>\$6,446,000,000</u></b>	<b><u>\$3,931,585,000</u></b>	<b><u>\$501,970,578</u></b>	<b><u>\$141,770,372</u></b>	<b><u>\$8,405,108</u></b>	<b><u>\$(368,605,314)</u></b>

<sup>a</sup> Issuance costs and underwriters discount were reported as part of the cost-of-carry in our report No. 2013-011.

<sup>b</sup> The PLA/CLA 2012A bond issue occurred during the 2012 calendar year, therefore, the cost-of-carry amount was adjusted for the related issuance costs and underwriters discount.

Source: Citizens' records.

While Citizens had taken reasonable steps to minimize its cost-of-carry, it may be possible over time to further reduce these costs as, pursuant to State law,<sup>28</sup> the premiums collected become more consistent with those calculated using actuarially determined rates. For example, as shown in Table 3, the use of actuarially determined rates may have produced additional PLA/CLA and Coastal account premiums of up to \$1.96 billion for the period January 1, 2012, through December 31, 2014. The availability of these resources as surplus, together with the earnings thereon, would have reduced the amount of debt financing required.

**Recommendation: We recommend that Citizens' management continue efforts to reduce the cost-of-carry on pre-event financing while maintaining the safety and liquidity of the financing proceeds through conservative investment. To reduce the amount of debt financing required, we also recommend that, to the fullest extent authorized, Citizens collect premiums based upon actuarially determined rates.**

CLAIMS HANDLING

The Citizens Claims Division was organized into multiple teams to facilitate both field and desk adjustments. Citizens established claims teams for residential and commercial lines and for specialized claim types such as those relating to sinkholes. Support for claims staff was provided by a Special Investigation Unit, a Litigation Unit, and a Vendor Relationship team. Additionally, Citizens augmented claims staffing as necessary by utilizing contracted adjusters (CAs) who were to receive annual training by Citizens regarding ethics and claims processing.

Documentation of claims processing, administration, and tracking was retained in multiple internal information systems. Citizens promulgated written policies and guidelines to ensure claims were processed in accordance with industry best practices, including timely and appropriate documentation of verification of coverage, indemnity paid (losses) including associated expenses, retention of experts if

<sup>28</sup> Section 627.351(6)(n), Florida Statutes.

applicable, provision of damage estimates to policyholders, and establishment of reserves.<sup>29</sup> To ensure that claims were processed in accordance with Citizens' policies and guidelines, Citizens established an enterprisewide quality assurance program with a unit dedicated to reviewing claims. Table 9 summarizes Citizens' claims activities during the period January 1, 2012, through August 31, 2014.

**Table 9**  
**Citizens' Claims Data<sup>a</sup>**  
**For the Period January 1, 2012, Through August 31, 2014**

Year	Number of Claims Filed	Total Indemnity Paid on Claims Filed	Allocated Loss Adjustment Expense on Claims Filed	Loss and Allocated Loss Adjustment Expense Case Reserves on Claims Filed
2012	44,222	\$ 644,882,699	\$ 90,099,732	\$ 1,203
2013	24,690	317,113,399	32,772,085	18,313
2014 <sup>b</sup>	8,087	85,380,102	7,875,938	20,629
<b>Totals</b>	<b><u>76,999</u></b>	<b><u>\$1,047,376,200</u></b>	<b><u>\$130,747,755</u></b>	<b><u>\$40,145</u></b>

<sup>a</sup> Amounts include only closed claims and expenses up to the date of closing.

<sup>b</sup> 2014 calendar year data includes claims data from January through August.

Source: Citizens' claims records.

### **Finding 6: Contracted Adjusters Conflicts of Interest**

To ensure claims were consistently and timely processed in accordance with Citizens' best practices and guidelines, Citizens' management assigned each claim to an adjuster for processing. Citizens' employee adjusters routinely processed claims, and any remaining claims or overflow from catastrophe claims were outsourced to CA firms. All adjusters were required to be licensed and appointed. Both employee adjusters and CAs were provided training related to Citizens' claims processes. Additionally, all adjusters were to annually attend training regarding Citizens' Corporate Ethics policies and complete standard forms to document their training attendance and acceptance of Citizens' ethics policies. To mitigate the potential for adjusters to be assigned claims involving related parties, Citizens required CA firms to annually certify through completion of a standard form that neither the firm nor any of its adjusters had a conflict of interest related to Citizens' claims assignments. Citizens retained copies of the forms along with other credentialing requirements for CA firms and their adjusters.

As part of our audit, we reviewed Citizens' records related to 35 CAs representing 15 CA firms to determine whether Citizens adequately documented that CAs were independent of, and had no conflict of interest in, the claims they were assigned to process. Our audit procedures disclosed that for 5 of the CA firms involving 11 of the 35 CAs, the CA firm conflict of interest forms were not current. Specifically, as of March 18, 2015, from 798 to 1,497 days had elapsed from the date of the most recent forms.

<sup>29</sup> Property insurance contracts provide protection from damage, loss and liability (indemnity) in exchange for premiums. The liability for unpaid losses and associated loss adjustment expenses are estimated at the time of loss, and appropriate reserves are established and adjusted as the claim is processed.

In response to our audit inquiry regarding five CAs who were employed by the same CA firm, Citizens' management stated that the firm's form had lapsed and that an updated form had been obtained. For the remaining six CAs, Citizens' management stated that, due to an extended CA firm solicitation process resulting from bid protests, credentialing requirements, including obtaining conflict of interest statements, were extended to avoid placing additional administrative tasks on firms that may not receive a contract.

Documentation demonstrating that CAs are independent of, and have no conflict of interest in, the claims they are assigned to process would provide greater assurance that claims are being handled in an independent and impartial manner.

**Recommendation: We recommend Citizens' management ensure that documentation is maintained to demonstrate that all CAs are independent of, and have no conflict of interest in, the claims they are assigned to process.**

## PROPERTY RECORDS AND INVENTORIES

Effective controls for the management of property require that property items be adequately controlled and accounted for by management. To record and maintain accountability for all property items, Citizens had established three separate asset management functions. General assets, such as office furniture and vehicles, were administered by the Facilities and General Services (FGS) Division and maintained in the Computer Aided Facilities Management (CAFM) system. The Information Technology Asset Management (ITAM) section maintained IT asset records in an ACCESS database, while telephonic and audio-visual (TAV) property records were maintained by the Systems Administration and Engineering section in an Excel worksheet. Citizens' policies and procedures<sup>30</sup> specified that the respective property custodians ensure that an annual physical inventory verifying the existence and location of at least 25 percent of Citizens' assets was to be conducted at least once each fiscal year and a complete inventory was to be conducted every 3 years. Although not required by the policies and procedures, Citizens' management indicated that IT assets were to be subject to an annual physical inventory. As described in Finding 7, our audit procedures found that Citizens' property controls needed enhancement.

### Finding 7: Property Controls

As part of our audit, we analyzed general asset, IT, and TAV property records for completeness of information and compliance with Citizens' asset management policies and procedures. Our audit procedures disclosed that Citizens' policies and procedures did not effectively ensure the complete and proper recording and physical inventory of Citizens' property. Specifically, we found that:

- Citizens' policies and procedures did not specify the information required to provide for accountability and safeguarding of property. Identifying the minimum information required, including, but not limited to, the asset tag number, description, model number, serial number, acquisition date, and location would better ensure that there is sufficient information to properly account for property items. The absence of these requirements may also have contributed to the issues noted during our analyses of Citizens' property records. Specifically:

<sup>30</sup> Policy No. 903, *Asset Management*. Although the policy was in draft form during the period covered by our audit and during our audit field work, Citizens' management indicated, in response to our audit inquiry, that they had been following the draft policy.

- Our analysis of Citizens' ITAM records as of January 2015 disclosed that for the 14,068 IT property items recorded, ITAM records did not identify the individual to whom 941 items were assigned or include a serial number and location for 31 items or an acquisition date for 8,970 items. Additionally, 41 items had no asset tag number assigned in the property records. The property items included in the ITAM database included assets such as laptop computers, servers, and tablets.
- Our analysis of Citizens' TAV property records as of February 2015 disclosed that for the 4,111 TAV property items recorded, the TAV property records did not include the acquisition date for any of the 4,111 items. Further, the TAV property records did not identify the individual to whom 254 property items were assigned or include the serial numbers for 518 items or the descriptions for 43 items. Additionally, 110 items had no asset tag number assigned in the property records.
- Citizens' FGS and TAV property custodians did not document the regular physical inventory of assets, reconciliation of the inventory results to the property records, or resolution of any identified differences. In response to our audit inquiry, Citizens' management stated the FGS Division had completed the first general assets property inventory in the second quarter of 2013. However, no records of the inventory were retained, and records of any subsequent inventories were not available. Management of Citizens' TAV property management function stated in response to our audit inquiry that records of TAV inventories were not retained, and instead, the TAV property administrator updated the Excel worksheet after each physical inventory was performed. Although Citizens' management stated and Citizens' policies and procedures required that discrepancies between the property records and the physical inventory results were to be investigated, none of Citizens' property management functions required the assigned property custodian to certify the periodic inventory. Certification by the assigned custodian would provide greater assurance that periodic physical inventories were performed, the inventory results were properly reconciled to the property records, and any identified differences were timely resolved.

Absent effective controls that ensure the appropriate recording and physical inventory of property items, Citizens' management has limited assurances regarding the appropriate accounting for and safeguarding of Citizens' property. Additionally, recognizing that IT equipment such as computers and other data storage devices are more susceptible to loss and theft due to their portability and adaptability to personal use, and that such items may contain nonpublic or sensitive information, controls designed to ensure the proper accountability for these items and any sensitive and confidential data they may contain are especially important.

**Recommendation:** We recommend that Citizens' management enhance controls to ensure that all property items are recorded in the property records with the information required for proper accountability. Additionally, we recommend that documentation be retained to demonstrate the performance of periodic physical inventories, the reconciliation of the inventory results to the property records, and the resolution of any noted differences.

#### INFORMATION TECHNOLOGY CONTROLS

As part of our audit we also evaluated the actions taken by Citizens' management to correct deficiencies disclosed in our report No. 2015-017 related to IT controls of selected systems utilized by Citizens.

#### **Finding 8: Security Controls**

As part of our audit, we performed follow-up procedures to determine whether Citizens' management had taken appropriate actions to correct the findings noted in our report No. 2015-017 that identified areas in

which improvements in Citizens' IT controls and operational processes were needed. Our follow-up procedures found that Citizens' management had taken corrective actions to address finding No. 1 related to certain inappropriate access privileges, and had substantially corrected the deficiencies disclosed in finding No. 2 related to periodic reviews of user access privileges. However, although Citizens' management had taken steps to address the security control issues identified in finding No. 3, further actions were necessary to better ensure the confidentiality, integrity, and availability of Citizens' data and IT resources. 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 Citizens' management of the specific issues.

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

## ***PRIOR AUDIT FOLLOW-UP***

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Except as discussed in the preceding paragraphs, Citizens' management had taken corrective actions for the findings included in our report Nos. 2013-011 and 2015-017.

## ***OBJECTIVES, SCOPE, AND METHODOLOGY***

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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 from July 2014 through May 2015 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 of Citizens Property Insurance Corporation (Citizens) focused on claims handling, customer service, take-out programs and bonuses, underwriting and eligibility, financing agreements, procurement of goods and services, internal controls, and the internal audit function. The overall objectives of the audit were:

- To evaluate management's performance in establishing and maintaining internal controls, including controls designed to prevent and detect fraud, waste, and abuse, and in administering assigned responsibilities in accordance with applicable laws, administrative rules, contracts, grant agreements, and guidelines.
- To examine internal controls designed and placed in operation to promote and encourage the achievement of management's control objectives in the categories of compliance, economic and efficient operations, the reliability of records and reports, and the safeguarding of assets, and identify weaknesses in those internal controls.
- To determine whether management had corrected, or was in the process of correcting, all deficiencies disclosed in our report Nos. 2013-011 and 2015-017.

- To identify statutory and fiscal changes that may be recommended to the Legislature pursuant to Section 11.45(7)(h), Florida Statutes.

This audit was designed to identify, for those programs, activities, or functions included within the scope of the audit, deficiencies in management's internal controls, instances of noncompliance with applicable governing laws, rules, or contracts, and instances of inefficient or ineffective operational policies, procedures, or practices. The focus of this audit was to identify problems so that they may be corrected in such a way as to improve government accountability and efficiency and the stewardship of management. Professional judgment has been used in determining significance and audit risk and in selecting the particular transactions, legal compliance matters, records, and controls considered.

As described in more detail below, for those programs, activities, and functions included within the scope of our audit, our audit work included, but was not limited to, communicating to management and those charged with governance the scope, objectives, timing, overall methodology, and reporting of our audit; obtaining an understanding of the program, activity, or function; exercising professional judgment in considering significance and audit risk in the design and execution of the research, interviews, tests, analyses, and other procedures included in the audit methodology; obtaining reasonable assurance of the overall sufficiency and appropriateness of the evidence gathered in support of our audit's findings and conclusions; and reporting on the results of the audit as required by governing laws and auditing standards.

Our audit included the selection and examination of transactions and records. Unless otherwise indicated in this report, these transactions and records were not selected with the intent of statistically projecting the results, although we have presented for perspective, where practicable, information concerning relevant population value or size and quantifications relative to the items selected for examination.

An audit by its nature, does not include a review of all records and actions of agency management, staff, and vendors, and as a consequence, cannot be relied upon to identify all instances of noncompliance, fraud, abuse, or inefficiency.

In conducting our audit we:

- Examined 20 customer care monitoring reports, from the population of 13,057 customer care monitoring reports prepared by Citizens during the period January 2013 through August 2014, to evaluate the adequacy of Citizens' monitoring procedures for call center personnel.
- Examined Citizens' organizational structure as of July 2014 to determine whether Citizens created an organizational structure that supported providing the policyholder customer service no less comparable than generally available in the voluntary market.
- To measure policyholder satisfaction, sent surveys to 1,020 policyholders, selected from Citizens' policyholder systems and the population of 984,731 policyholders who had policies in effect at some point during the period September 2013 through August 2014, including 510 policyholders who had claims that were closed during that same period. We then combined and analyzed the survey responses from the 202 policyholders who returned the survey.
- To measure appointed agent satisfaction with Citizens' services, sent surveys to 744 of the 9,658 agents who held a Citizens appointment during the period January 2013 through August 2014. We then combined and analyzed the survey responses from the 130 appointed agents who returned the survey.

- Examined documentation for 30 complaints, from the population of 2,266 complaints recorded by Citizens during the period January 2013 through July 2014, to determine whether Citizens had taken adequate actions to resolve the complaint.
- Examined documentation for 31 complaints, from the population of 4,035 complaints and inquiries forwarded from the Department of Financial Services (DFS) to Citizens during the period January 2013 through August 2014, to determine whether Citizens had taken adequate actions to resolve the complaint. In addition, examined documentation for 40 complaints to determine whether the complaints had been properly coded in Citizens' records.
- Compared DFS complaint and inquiries data for the period January 2013 through June 2014 related to Citizens to corresponding data related to other large residential, commercial, and other property and casualty insurers in the State to assess whether Citizens provided customer service of no less than the quality generally provided in the voluntary market.
- Engaged a specialist to examine documentation related to 203 claims, each in excess of \$1,000, closed during the period August 2013 through August 2014, including 40 sinkhole, 40 water damage, and 45 public adjuster claims, to determine the extent to which the claims were processed in accordance with Citizens' policies and procedures and the extent to which the claims were properly adjusted.
- Performed inquiries and inspected selected documents and records to determine whether Citizens had designed and established a claims quality assurance program to ensure that claims were processed in compliance with governing laws, rules, and guidelines.
- Performed inquiries and inspected selected documents and records to determine whether Citizens had designed and established a catastrophe response plan.
- Examined documentation for 40 claims adjusters, selected from the population of 16,377 claims adjusters identified in records of claims received during the period August 2013 through August 2014, to determine whether the claims adjusters were qualified, independent with respect to assigned claims, and adequately trained.
- Examined documentation related to 5 of 65 assumptions (take-outs) executed during the period September 2013 through August 2014 to determine whether Citizens' depopulation function operated effectively, whether the assumptions were performed in accordance with applicable statutes, and whether the assumptions were approved by the Office of Insurance Regulation (OIR).
- Performed inquiries, inspections of selected documents and records, and analytical procedures pertaining to reinsurance contracts executed with two participating take-out companies that removed approximately \$36.5 billion of exposure from Citizens in 2013 to determine whether the reinsurance contracts were made in accordance with applicable statutory and OIR requirements.
- Performed inquiries and inspected selected documents and records to determine whether the Florida Market Assistance Plan was being promoted and utilized to assist consumers in searching for property and casualty insurance in the voluntary market.
- From the population of all transactions processed through the Clearinghouse during the period January 27, 2014, through January 17, 2015, examined documentation related to 25 new applications and 25 renewal transactions to determine compliance with the requirements of Section 627.3518, Florida Statutes. Additionally, performed inquiries and inspected documents related to overrides of ineligibility determinations in the Clearinghouse system to evaluate Citizens' controls for making and documenting system overrides.
- Examined documentation related to 46 new personal and commercial line policies issued during the period September 2013 through August 2014 to determine whether policyholders were eligible for a Citizens' policy, appropriate underwriting criteria were applied, and the premium was correctly calculated.

- Analyzed data for personal lines policies newly written or renewed during the period January 1, 2014, through August 31, 2014, to determine whether Citizens complied with the \$1,000,000 statutory threshold for dwelling coverage, or dwelling and contents coverage for condominiums as applicable.
- Examined documentation related to 25 policy renewals, selected from the population of 848,058 policies in force for at least 1 year as of August 31, 2014, to determine whether policyholders were eligible for a Citizens' policy, appropriate underwriting criteria were applied, and the premium was correctly calculated.
- Examined documentation related to 25 policies in force as of August 31, 2014, which received wind mitigation credits and re-inspections related to those wind mitigation credits, to determine whether Citizens had established appropriate controls over the evaluation and award of wind mitigation credits, and the conduct of re-inspections related to those wind mitigation credits.
- Examined five mobile home policies for pre-1994 constructed mobile homes or manufactured homes to determine whether coverage was limited to actual cash value, and also examined five mobile home policies for post-1995 constructed mobile homes or manufactured homes to determine whether mobile home construction credits were accurate.
- Examined all financing arrangements entered into during the period July 2011 through August 2014 to determine whether the financing arrangements were properly approved at rates not considered to be excessive.
- Calculated the effect that pre-event liquidity had on Citizens' surplus.
- Analyzed the effect of Citizens' inability to charge actuarially determined insurance premium rates on Citizens' surplus for the 2011 through 2014 calendar years.
- Performed inquiries and reviewed applicable documents and records to evaluate Citizens' procedures for estimating its probable maximum loss obligations.
- Performed inquiries and inspected selected documents and records during the period August 2014 through February 2015 to determine whether Citizens had appropriately monitored its external investment managers.
- Performed analytical procedures to determine whether Citizens' investment performance was consistent with that of investment indices with similar characteristics for the period of September 2013 through August 2014.
- Performed analytical procedures to determine whether Citizens received emergency assessments from all applicable insurers for the 2013 calendar year.
- Examined 23 contracts with estimated costs over \$25,000, or \$35,000 as applicable, from the population of 242 contracts totaling \$429,740,226 and awarded during the period January 2013 through October 2014, to determine whether the contracts were procured in accordance with Sections 627.351(6)(e), and 287.057, Florida Statutes, and Citizens' policies and procedures.
- Examined payment documentation for 28 contracts with estimated costs over \$25,000, or \$35,000 as applicable, which were active during the period January 2013 through October 2014 to determine whether the goods and services were received, the contracts were monitored, and contract payments were made in accordance with the contract.
- Performed inquiries and inspected selected documents and records to evaluate Citizens' internal controls over the procurement of legal services during the period February 2015.
- Examined documentation for ten general expense payments, totaling \$190,222, made during the period January 2013 through August 2014 to evaluate whether Citizens' controls were sufficient to ensure that payments (including payments for wireless telephones and services) were made in

accordance with Citizens' policies and procedures and were reasonable, properly approved, reviewed, and recorded.

- With respect to the execution of the lease for downtown Jacksonville, Florida, office space, determined Citizens' compliance with Florida Statutes, including Chapter 255, Florida Statutes, through a review of applicable lease documents, including procurement documents and documented communications with the Department of Management Services.
- Observed, documented, and evaluated the effectiveness of selected Citizens' processes and procedures for ensuring the proper control and safeguard of, and accountability for, Citizens' property items, including property items of a sensitive or attractive nature in accordance with applicable guidelines.
- Analyzed general asset, information technology, and telephonic and audio-visual property records for completeness of information and compliance with Citizens' asset management policies and procedures. In addition, from the population of \$25,483,075 in purchases of tangible personal property and sensitive and attractive items made during the period March 2011 through December 2014, examined documentation related to ten purchases to determine whether the purchases were necessary, properly approved and recorded, received, and subsequently inventoried.
- Performed inquiries and inspected selected documents and records to determine whether Citizens' internal audit function operated in compliance with applicable professional auditing standards and statutory requirements.
- Performed inquiries and inspected selected documents and records to determine whether Citizens had adequately designed and implemented an Enterprise Risk Management framework.
- Performed inquiries and inspected selected documents and records to determine whether Citizens' procedures adequately identified and protected nonpublic information.
- Evaluated Citizens' actions to correct the findings noted in our information technology operational audit report No. 2015-017. Specifically, we:
  - Observed and evaluated the effectiveness of application access controls in appropriately restricting access to the Citizens Insurance Suite (PolicyCenter® as of April 14, 2015, ClaimCenter® as of May 12, 2015, and BillingCenter® as of May 13, 2015) and Electronic Policy Administration System (ePAS) as of May 4, 2015. Specifically, for 40 active user accounts in the Citizens Authentication Gateway (CAG) we evaluated the appropriateness of user access privileges to the Citizens Insurance Suite and ePAS.
  - Observed and evaluated the effectiveness of periodic reviews of user access privileges to the CAG, ePAS, Credentialing Administration Information System and the related network operating system as of May 4, 2015, and Wind System as of April 30, 2015.
  - Evaluated the appropriateness of logical access controls to the CAIS, the Agent Appointment System, and the related network operating system.
- Communicated on an interim basis with applicable officials to ensure the timely resolution of issues involving controls and noncompliance.
- Performed various other auditing procedures, including analytical procedures, as necessary, to accomplish the objectives of the audit.
- Prepared and submitted for management response the findings and recommendations that are included in this report and which describe the matters requiring corrective actions. Management's response is included in this report under the heading **MANAGEMENT'S RESPONSE**

## ***AUTHORITY***

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Section 627.351(6)(m), Florida Statutes, requires the Auditor General to conduct an operational audit of Citizens Property Insurance Corporation every 3 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.



Sherrill F. Norman, CPA  
Auditor General

## MANAGEMENT'S RESPONSE

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CITIZENS PROPERTY INSURANCE CORPORATION  
2312 KILLEARN CENTER BLVD., BUILDING A  
TALLAHASSEE, FLORIDA 32309

TELEPHONE: (850) 513-3746 FAX: (850) 513-3903



August 26, 2015

Ms. Sherrill F. Norman, CPA  
Auditor General  
G74 Claude Pepper Building  
111 West Madison Street  
Tallahassee, Florida 32399-1450

Dear Ms. Norman:

Enclosed are the written statements of explanation from Citizens Property Insurance Corporation to the each of the findings of the preliminary and tentative audit findings as provided electronically by your office on July 31, 2015.

These written statements concerning the findings include current or proposed corrective actions. Our staff has worked through any initial questions that arose with your office in order to produce this document.

Should any additional questions or issues arise from this submission, please do not hesitate to contact Christine Ashburn at (850) 513-3746 or via email at [christine.ashburn@citizensfla.com](mailto:christine.ashburn@citizensfla.com).

Regards,

A handwritten signature in black ink that reads "Barry J. Gilway".

Barry Gilway  
President/CEO and Executive Director

Enclosure

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Chris Gardner, Chairman, Orange County • Gary Aubuchon, Lee County  
Bette Brown, Monroe County • Juan Cocuy, Palm Beach County • Don Glisson, Jr., St. Johns County  
Jim Henderson, Seminole County • James Holton, Pinellas County • Freddie Schinz, Okaloosa County  
John Wortman, St. Johns County • Barry Gilway, President/CEO and Executive Director

**Citizens Property Insurance Corporation – Operational Audit  
Management Response**

**Underwriting and Eligibility**

**Finding No. 1:** Citizens' controls did not always ensure that only eligible policies were issued or renewed.

**Recommendation:** We recommend Citizens' management enhance procedures for complying with statutory coverage limits.

**Management Response:** Citizens management acknowledges that certain policies were renewed where the maximum coverage amount was exceeded due specifically to an increase in value from the application of an inflation factor. In order to non-renew a policy, the statutory nonrenewal period must be met (now 120 days). At the time for nonrenewal (120 days prior to policy expiration), there is not a reliable inflation factor available for the renewal date because inflation factors are adjusted quarterly. For this reason, a reliable replacement value, including inflation, could not be obtained for renewal. Accordingly, the property was renewed applying an updated inflation factor that caused the property to exceed the maximum value. Accordingly, the property was then identified for nonrenewal the following year.

The balance of errant policies not addressed above resulted from the omission of a particular policy form when manually reviewing all policies for eligibility for renewal based upon a newly enacted maximum replacement cost value for policies. When this specific group of policies was identified and reviewed, the policies could not be non-renewed, as the statutory nonrenewal period could not be met. Each of these policies have since been set to non-renew. Systematic control of the new business and nonrenewal processes have been programmed into our new policy system, Citizens Insurance Suite. The additional functionality available within this system will help ensure compliance in processing these types of policies in the future and provides an enhanced ability to audit this issue moving forward.

**Finding No. 2:** As similarly noted in our report No. 2013-011, Citizens' controls did not always ensure that errors in applications for coverage were timely corrected.

**Recommendation:** We recommend that Citizens' management continue to enhance controls for the review and approval of applications for coverage and, as applicable, correct identified errors prior to approving applications for coverage.

**Management Response:** As a result of the audit finding, Citizens will assess procedures related to the review and handling of information provided by the 360 Value tool. Enhancements will be made to ensure that the replacement cost estimates generated by the tool are arrived at through the use of the most accurate information available. Any revisions to underwriting procedures will be incorporated into the Quality Review Process with appropriate weighting given to the potential errors.

### Clearinghouse

**Finding No. 3:** Clearinghouse system overrides of policy ineligibility determinations were not traceable to the responsible individual.

**Recommendation:** We recommend Citizens' management ensure that, for each Clearinghouse system override, the identity of the specific user performing the override is recorded in the Clearinghouse system.

**Management Response:** As noted in the audit findings an enhancement was implemented in the Clearinghouse on June 7, 2015 that identifies the specific admin user when an override of a determination of ineligibility made by the Clearinghouse is performed. This information is stored in a database that allows for up-to-date reporting of override activity. Only override activity performed after June 7, 2015 will have the specific user identified by the Clearinghouse. Prior overrides cannot be added to the database. A current copy of the override activity report can be provided if needed.

### Customer Service

**Finding No. 4:** Analysis of customer service data and surveys of policyholders and agents indicated that Citizens provided customer service comparable to the quality generally provided in the voluntary market.

**Recommendation:** We recommend that Citizens' management continue efforts to provide quality customer service.

**Management Response:** Citizens is committed to providing quality customer service to our policyholders, agents and the constituents of Florida. Citizens has recently implemented a Voice of the Customer survey program for policyholders which is providing key customer feedback that drives process improvement opportunities companywide. Citizens has also expanded our agent outreach activities and support. Previously, Citizens met with our Agent Roundtable members quarterly. We have enhanced our agent outreach calendar and now meet monthly. These meetings are used to understand, from the agent perspective, what processes and workflows work well and which need improvement. Deliverables are tracked and reported accordingly to ensure agent-focused progress.

### Probable Maximum Loss Financing

**Finding No. 5:** While Citizens had taken reasonable steps to minimize its net financing costs (cost-of-carry), it may be possible over time to further reduce these costs as, pursuant to State law (Section 627.351(6)(n), Florida Statutes), the premiums collected become more consistent with those that would be calculated using actuarially determined rates.

**Recommendation:** We recommend that Citizens' management continue efforts to reduce the cost-of-carry on pre-event financing while maintaining the safety and liquidity of the financing proceeds through conservative investment. To reduce the amount of debt financing required, we also recommend that, to the fullest extent authorized, Citizens collect premiums based upon actuarially determined rates.

**Management Response:** Citizens agrees and works diligently to minimize the cost of carry on pre-event financing. Citizens Staff and their Financial Advisor have worked continuously in an

effort to reduce the cost of carry since its last financing in 2012. All of these efforts resulted in a ratings upgrade of one notch from both Moody's and Fitch which helped significantly to lower the overall interest cost of Series 2015A bonds. Citizens' Series 2015A Bonds true interest cost was 2.66%, or 1.50% lower than for the Coastal Series 2011A Bonds (3-10 year maturities), even with an average life greater by 0.79 years, primarily due to Citizens efforts in reducing credit spread. In addition, investment policies for bond proceeds have also been revised annually to ensure an appropriate return is made while still maintaining the safety and liquidity of the bond proceeds through conservative investment mandates.

### **Claims Handling**

**Finding No. 6:** Citizens did not always appropriately document that contracted adjusters were independent of, and had no conflict of interest in, the claims they were assigned to process.

**Recommendation:** We recommend Citizens' management ensure that documentation is maintained to demonstrate that all CAs are independent of, and have no conflict of interest in, the claims they are assigned to process.

**Management Response:** Claims Vendor Relations' annual credentialing process includes the Adjuster Conflict of Interest form, and we have recently updated the forms in alignment with this recommendation. We concur with the finding and recognize the importance of this in our annual processes.

### **Property Records and Inventories**

**Finding No. 7:** Controls over Citizens' property items need enhancement.

**Recommendation:** We recommend that Citizens' management enhance controls to ensure that all property items are recorded in the property records with the information required for proper accountability. Additionally, we recommend that documentation be retained to demonstrate the performance of periodic physical inventories, the reconciliation of the inventory results to the property records, and the resolution of any noted differences.

**Management Response:** IT will update the existing IT Asset Management policy and procedures to align to Citizens' corporate level requirements by December 2015. Due to on-going projects that have direct bearing on IT Asset Management activities (Jacksonville Office Consolidation, Enterprise Resource Management and various accounting projects), the consolidation of technology asset inventories and refinement of IT Asset Management controls will be addressed as part of the 2016 annual inventory.

FGS will implement enhanced controls to ensure that all appropriate FGS assets are properly inventoried and that periodic physical inventories are recorded to demonstrate timeline and results.

### **Information Technology Controls**

**Finding No. 8:** Certain security controls related to selected Citizens' IT systems continue to need improvement.

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

**Management Response:** Management took note of the findings and are implementing appropriate controls.