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February 11, 2008

Mr. Kevin M. McCarty
Commissioner of Insurance
Office of Insurance Regulation
J. Edwin Larson Building, Suite 101
200 East Gaines Street
Tallahassee, FL 32399

Re: Follow Up in the case of Auditor General Report No. 2006-0096 – Operational Audit of
Citizens Property Insurance Corporation – dated January 26, 2006

Dear Commissioner McCarty:

A follow up to referenced Operational Audit was not originally planned by management of the Office of Insurance Regulation (the Office), owing to the fact that the audit was labeled as an operational audit of Citizens Property Insurance Corporation. The Office forwarded explanatory information and comments to the Auditor General in response to Findings 3, 9, 10 and 16 that were included within the Preliminary and Tentative Findings that were associated with referenced audit. Notwithstanding the foregoing, a recent discussion with a member of the Joint Legislative Auditing Committee (JLAC) Staff revealed that the Office was expected to provide follow up information in response to Auditor General Report No. 2006-96.

Please let me know if you have any questions regarding this matter.

Sincerely,

A. E. Callahan, CIG, CIA, CISA, CFE, PAHM, FAHM

AEC:acc

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Follow Up To Audit General Report 2006-096

Copy to:

✓ Joint Legislative Auditing Committee
404 South Monroe Street
Tallahassee, FL 32399-1100

Audrey Sumrall Brown, Chief of Staff, Office of Insurance Regulation

Belinda Miller, Deputy Commissioner, Property & Casualty Product Review, Office of Insurance Regulation

Bonnie Deering, Audit Director, Office of Inspector General, Office of Insurance Regulation

Follow up responses that follow are keyed to the summarized, numbered findings within the Auditor General's Report No. 2006-096.

Finding No. 3: Background Investigations

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

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

OIR Follow up Comments and Information

The Auditor General raised the question of whether the board members and the corporate officers of Citizens were required to submit background information at the time of employment. The statute relating to this issue has been changed to provide that all of the board members and the officers of Citizens must submit background information to the Office in a manner identical to that required of officers and directors of insurance companies. No significant background issues have been uncovered as a result of these checks. The conflict of interest and background language is provided below for information and convenience.

(d)1. All prospective employees for senior management positions, as defined by the plan of operation, are subject to background checks as a prerequisite for employment. The Office shall conduct background checks on such prospective employees pursuant to Sections 624.34, 624.404(3) and 628.261, Florida Statutes.

2. On or before July 1 of each year, employees of the Corporation are required to sign and submit a statement attesting that they do not have a conflict of interest, as defined in Part III of Chapter 112. As a condition of employment, all prospective employees are required to sign and submit to the Corporation a conflict-of-interest statement.

3. Senior managers and members of the Board of Governors are subject to the provisions of part III of chapter 112, Florida Statutes, including, but not limited to, the code of ethics and public disclosure and reporting of financial interests, pursuant to Section 112.3145, Florida Statutes. Senior managers and board members are also required to file such disclosures with the Commission on Ethics and the Office of Insurance Regulation. The Executive Director of the Corporation or his or her designee shall notify each newly appointed and existing appointed member of the Board of Governors and senior managers of their duty to comply with the reporting requirements of Part III of Chapter 112, Florida Statutes. At least

quarterly, the Executive Director or his or her designee shall submit to the Commission on Ethics a list of names of the senior managers and members of the Board of Governors who are subject to the public disclosure requirements under Section 112.3145, Florida Statutes.

4. Notwithstanding Section 112.3148 or Section 112.3149, Florida Statutes, or any other provision of law, an employee or board member may not knowingly accept, directly or indirectly, any gift or expenditure from a person or entity, or an employee or representative of such person or entity, that has a contractual relationship with the Corporation or who is under consideration for a contract. Employees or board members who fail to comply with the provisions of subparagraph 3. or with the provisions of this subparagraph is subject to penalties provided under Sections 112.317 and 112.3173, Florida Statutes.

5. Any senior manager of the Corporation who is employed on or after January 1, 2007, regardless of the date of hire, who subsequently retires or terminates employment, is prohibited from representing another person or entity before the Corporation for 2 years after retirement or termination of employment from the Corporation.

6. Any senior manager of the Corporation who is employed on or after January 1, 2007, regardless of the date of hire, who subsequently retires or terminates employment, is prohibited from having any employment or contractual relationship for 2 years with an insurer that has entered into a take-out bonus agreement with the Corporation.

Finding No. 9: Market Assistance Plan

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

OIR Follow up Comments and Information

OIR has no continuing management role with regard to the Florida Market Assistance Plan (FMAP). The OIR is a legally separate organization; therefore, in practice, Citizens' personnel who are associated with the FMAP report to a Citizens' Officer. As required, the Citizens Board meets as the FMAP Board prior to some of the Citizens Board Meetings. The FMAP Board approves the FMAP budget. Minutes of the FMAP Board Meetings may be requested from Citizens.

Finding No. 10: Take-Out Bonuses

Although Section 627.3511(2), Florida Statutes, appears to limit the amount of bonus that may be paid to an insurer to \$100 for each risk (policy) that the insurer removes, Citizens had developed several programs that provided bonuses of up to \$300 for each policy removed. The bonus amounts paid or escrowed for each policy have averaged \$148. In response to our inquiries, both Citizens and OIR responded that Section 627.351(6)(g)3.a., Florida Statutes,

authorizes the payment of bonuses in excess of \$100 for each policy taken out. That statute provides, "The Corporation shall adopt one or more programs subject to approval by the office (Office of Insurance Regulation) for the reduction of both new and renewal writings in the corporation." Citizens should seek legislative clarification of its authority to pay bonuses in excess of the \$100 statutory limit established by Section 627.3511(2), Florida Statutes.

OIR Follow up Comments and Information

As indicated above, Citizens had been offering a variety of take-out bonus programs, and the Auditor General questioned whether Citizens could offer programs other than the \$100 take-out bonus program that was provided for in Section 627.3511, Florida Statutes. Citizens had been relying on another phrase within Section 627.351, Florida Statutes, that Citizens' general counsel believed allowed Citizens to adjust the terms of take-out bonus programs.

The take-out bonus statute still provides for take-out bonuses of up to \$100 for each policy removed if the bonus program is approved by Citizens' Board and the Office does not disqualify the insurer based on solvency, capacity issues, and the like. On the other hand, the 2007 Legislature revised the conditions for eligibility for Citizens' policies and this has had an effect on take-out processes. In this regard the 2007 Legislature addressed, among other issues, complaints received from policyholders whereby policies were taken out by Florida take-out companies and then the companies increased the policyholders' rates. Under previous law policyholders were ineligible for Citizens' policies if they had received an offer of coverage from an insurer in the voluntary market. The Legislature addressed this issue by changing the eligibility requirements so that policyholders are now allowed to continue coverage by Citizens if they receive a take-out offer from an insurer in the voluntary market but do not desire to receive coverage from that insurer. The currently effective statute requires the Citizens Plan of Operation, which was revised and approved by the Financial Services Commission, to provide for this coverage as indicated by the language that is provided below for information and convenience.

5. Must provide a procedure for determining the eligibility of a risk for coverage, as follows:

a. Subject to the provisions of s. 627.3517, with respect to personal lines residential risks, if the risk is offered coverage from an authorized insurer at the insurer's approved rate under either a standard policy including wind coverage or, if consistent with the insurer's underwriting rules as filed with the office, a basic policy including wind coverage, for a new application to the Corporation for coverage, the risk is not eligible for any policy issued by the Corporation unless the premium for coverage from the authorized insurer is more than 15 percent greater than the premium for comparable coverage from the Corporation. If the risk is not able to obtain any such offer, the risk is eligible for either a standard policy including wind coverage or a basic policy including wind coverage issued by the corporation; however, if the risk could not be insured under a standard policy including wind coverage regardless of market conditions, the risk shall be eligible for a basic policy including wind coverage unless rejected under subparagraph 9. However, with regard to a policyholder of the Corporation or a policyholder removed from the Corporation through an assumption agreement until the end of the assumption period, the

policyholder remains eligible for coverage from the Corporation regardless of any offer of coverage from an authorized insurer or surplus lines insurer. The Corporation shall determine the type of policy to be provided on the basis of objective standards specified in the underwriting manual and based on generally accepted underwriting practices.

Following this change Citizens and others thought that the ability of policy holders to reject take-outs would make it impossible for take-outs to be accomplished. However, after meeting with interested parties, Citizens has been able to create a process to permit policy take-out activity to continue and to even thrive. In a recent report, for example, the Depopulation Committee of the Citizens Board reported that during 2007 seven insurance companies removed 247,923 personal residential multi-peril policies from Citizens with a total exposure of \$68,259,426,361. This was accomplished without the use of a bonus program.

The process for take-outs requires the take-out company to send a letter to the policyholder 30 days in advance of the take-out and provide the policyholder an opportunity to accept the offer by signing the bottom of the letter and returning it to the company or rejecting the offer by sending an e-mail to the company. If the policyholder rejects the offer, their policy is not removed from Citizens. If the policyholder does not reject the offer, but indicates to Citizens that continuation of Citizens' coverage is desired prior to expiration of the Citizens policy period, the policyholder is eligible for continued coverage by Citizens and Citizens then has to manually restore their coverage. To facilitate this process, takeout companies must retain electronic files that can be used to return policyholders who reject take-out offers. Experience has shown that this process has worked well. Experience has also shown that less than 5% of policyholders who have been offered take-out coverage have rejected such offers, resulting in restoration of their Citizens' coverage being required.

Finding No. 16: Actuarial Soundness of Rates

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

OIR Follow up Comments and Information

Under previous law, Citizens made a rate filing and, like any other company's rate filing, the filing was then made subject to OIR approval or disapproval. If the filing was disapproved by OIR, then Citizens had a right to an administrative hearing. The law was changed in 2007 so that Citizens now makes filings which include recommended rates; however, OIR actually sets the rates and such rates are not subject to appeal by Citizens. Additionally, the statutory change in 2007 froze personal residential rates until 2009 and also rescinded a rate filing of Citizens that had already been approved by OIR. The statutory language pertinent to this matter is provided below for information and convenience.

(m)1. Rates for coverage provided by the Corporation shall be actuarially sound and subject to the requirements of Section 627.062, Florida Statutes except as otherwise provided in this paragraph. The Corporation shall file its recommended rates with the office at least

annually. The Corporation shall provide any additional information regarding the rates which the Office requires. The Office shall consider the recommendations of the board and issue a final order establishing the rates for the Corporation within 45 days after the recommended rates are filed. The Corporation may not pursue an administrative challenge or judicial review of the final order of the office.

2. In addition to the rates otherwise determined pursuant to this paragraph, the Corporation shall impose and collect an amount equal to the premium tax provided for in Section 624.509, Florida Statutes, to augment the financial resources of the Corporation.

3. After the Public Hurricane Loss-Projection Model under Section 627.06281, Florida Statutes, has been found to be accurate and reliable by the Florida Commission on Hurricane Loss Projection Methodology, that model shall serve as the minimum benchmark for determining the windstorm portion of the Corporation's rates. This subparagraph does not require or allow the Corporation to adopt rates lower than the rates otherwise required or allowed by this paragraph.

4. The rate filings for the Corporation which were approved by the Office and which took effect January 1, 2007, are rescinded, except for those rates that were lowered. As soon as possible, the Corporation shall begin using the lower rates that were in effect on December 31, 2006, and shall provide refunds to policyholders who have paid higher rates as a result of that rate filing. The rates in effect on December 31, 2006, shall remain in effect for the 2007 and 2008 calendar years except for any rate changes that result in a lower rate. The next rate change that may increase rates shall take effect January 1, 2009, pursuant to a new rate filing recommended by the Corporation and established by the Office, subject to the requirements of this paragraph.