

# CITIZENS PROPERTY INSURANCE CORPORATION

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## Operational Audit



## **PRESIDENT AND EXECUTIVE DIRECTOR OF CITIZENS PROPERTY INSURANCE CORPORATION**

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

Nancy Baily, from August 2011  
Andrea Bennett, to July 2008  
William Corry, to July 2011  
Richard Dechene, to July 2008  
G. Bruce Douglas, Chair and Member to July 2008  
Carol Everhart  
Chris Gardner, from August 2011  
Gloria Fletcher, to July 2008  
Earl Horton, to July 2011  
Sherrill Hudson, from August 2008 to July 2011  
Alan Katz, to March 2010  
Harold M. Knowles, from April 2010, to July 2011  
Carlos Lacasa, from August 2008 (Chair from September 2011)  
Tom Lynch, from March 2009  
James Malone, Chair and Member from August 2008 to July 2011  
Jay Odom, to February 2009  
John Rollins, from September 2011  
Rob Wallace, from August 2011 to February 2012  
John Wortman, from September 2011  
Scott Wallace, President and Executive Director, to April 2012

The audit team leader was Allen G. Weiner, CPA, and the audit was supervised by Kathryn D. Walker, 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) 487-9085.

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**CITIZENS PROPERTY INSURANCE CORPORATION  
OPERATIONAL AUDIT**

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**CITIZENS PROPERTY INSURANCE CORPORATION**

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**SUMMARY**

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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 (Citizens) once every three years. Our audit focused on information technology controls, enterprise risk management, agent appointments, procurement, customer service, claims handling, take-out programs and bonuses, underwriting and eligibility, and financing arrangements. The findings of our audit are summarized below.

**UNDERWRITING**

**Finding No. 1:** Application reviews were not always effective in identifying errors in underwriting, which lead to the calculation of incorrect premiums in some instances.

**Finding No. 2:** In verifying the square-footage amounts shown by applications, Citizens did not always require the resolution of differences in the amounts shown by the applications and the amounts shown by the records of county property appraisers.

**MARKET ASSISTANCE PLAN**

**Finding No. 3:** While Citizens participated in various Market Assistance Plan promotional activities (for example, public service announcements, print and television outlets, etc.), additional opportunities exist to promote and increase the production of voluntary insurer placements. Specifically, promotional programs were generally not targeted at real estate professionals, mortgage companies and brokers, and others involved in the sale of real estate. Such promotional activities may help to increase the number of plan requests and voluntary insurer placements.

**TAKE-OUT PROGRAM**

**Finding No. 4:** Factors adversely impacting the effectiveness of Citizens' take-out program included Citizens' premium rates, which were viewed by some voluntary insurers as being too low, and the ability of policyholders and policyholder agents to opt-out of take-out offers.

**Finding No. 5:** Our audit disclosed that Citizens had overpaid the bonus amount due to a take-out insurance company. The amount of the overpayment, which has now been recouped, totaled \$2,584,438.

**CUSTOMER SERVICE**

**Finding No. 6:** Surveys of customers and agents indicated that most customers and agents had been satisfied with the level of customer and agent service and support. Also, an analysis of complaints data maintained by the Department of Financial Services indicated that Citizens' complaint experience was similar to that of other large Florida property and casualty insurers.

**CLAIMS HANDLING**

**Finding No. 7:** Citizens did not always perform an insurance-to-value calculation at the time of loss adjustment and, therefore, was not able to enforce policy co-insurance clauses included in its various policies.

**PROBABLE MAXIMUM LOSS FINANCING**

**Finding No. 8:** 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 Section 627.351(6)(n), Florida Statutes, the premiums charged and collected become more consistent with those that would be calculated using actuarially-determined rates. Citizens should continue its efforts to reduce the cost-of-carry on any pre-event financing, while maintaining the safety and liquidity of the financing proceeds through conservative investment.

**PROCUREMENT**

**Finding No. 9:** Citizens amended its procurement policies to more effectively control the award of emergency and sole source contracts.

**INFORMATION TECHNOLOGY CONTROLS**

**Finding No. 10:** Citizens did not always timely remove terminated employee access to information technology resources.

**Finding No. 11:** IT security controls needed enhancement.

<b>BACKGROUND</b>
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Effective July 1, 2002, pursuant to amendments made to Section 627.351, Florida Statutes, by Chapter 2002-240, Laws of Florida, Citizens Property Insurance Corporation (Citizens) was created to provide, as the State's last resort insurer, residential and commercial property insurance. Pursuant to those amendments, the policies, obligations, rights, assets, and liabilities of both the Florida Residential Property and Casualty Joint Underwriting Association (FRPCJUA) and the Florida Windstorm Underwriting Association (FWUA) became the policies, obligations, rights, assets, and liabilities of Citizens. Subsequently, Chapter 2007-90, Laws of Florida, modified the mission of Citizens from that of providing property insurance to only those applicants who are in good faith entitled to procure insurance through the voluntary market but are unable to do so, to providing affordable property insurance to applicants who are in good faith entitled to procure insurance through the voluntary market but are unable to do so.

In accordance with Section 627.351(6), Florida Statutes, Citizens' Plan of Operation required that Citizens operate subject to the supervision and approval of an eight-member Board of Governors (Board). The Governor, the Chief Financial Officer, the President of the Senate, and the Speaker of the House are each to appoint two members of the Board, and at least one of the two members appointed by each appointing officer must have demonstrated expertise in insurance. Also, in accordance with statute, the Plan of Operation required that Citizens' Executive Director and senior managers be engaged and serve at the pleasure of the Board. The Executive Director is to be responsible for employing other staff as the Corporation may require, subject to review and concurrence by the Board.

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

- *Personal lines account (PLA)* - for personal residential policies issued by Citizens or issued by the FRPCJUA and renewed by Citizens. Such policies are to provide comprehensive, multi-peril coverage on risks that are not located in areas eligible for coverage in the FWUA, as those areas were defined on January 1, 2002. The account is to also include policies that do not provide coverage for the peril of wind on risks that are located in such areas.
- *Commercial lines account (CLA)* - for commercial residential and commercial nonresidential policies issued by Citizens or issued by the FRPCJUA and renewed by Citizens. Such policies are to provide coverage for basic property perils on risks that are not located in areas eligible for coverage in the FWUA, as those areas were defined on January 1, 2002. The account is to also include policies that do not provide coverage for the peril of wind on risks that are located in such areas.
- *High-risk/Coastal account<sup>1</sup> (HRA)* - for personal residential policies and commercial residential and commercial nonresidential property policies issued by Citizens or transferred to Citizens that provide coverage for the peril

<sup>1</sup> Pursuant to Section 15, Laws of Florida 2011-39, the High-risk account was renamed the Coastal account, effective May 17, 2011.

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 below, provides a summary by account, of the Citizens policies in force, the premiums with surcharges, and the amount of exposure, as of December 31, 2009, 2010, and 2011. As shown by Table 1, the number of policies in force during this period increased by approximately 443,000, or by 43 percent. In testimony before the Florida Senate's Banking and Insurance Committee, Citizens' management attributed these increases, primarily in the PLA account to several factors.<sup>2</sup> These included, but were not limited to:

- Citizens' premiums were likely lower than the premiums available in the voluntary market due to Citizens not having to return profits to shareholders, pay taxes, purchase as much reinsurance, or advertise, and because of the statutorily required rate freezes and the doubling of wind mitigation credits. (Additional details relating to the rate freezes are provided in the succeeding paragraph.)
- Captive agents wrote additional Citizens policies because their employer insurance company may not have been writing new policies.<sup>3</sup>
- Citizens' underwriting criteria were less stringent than those of voluntary market insurers and, as a consequence, Citizens could write policies or underwrite structures that voluntary insurers may not write.
- Voluntary insurers were underserving markets in southeast Florida and in sinkhole territories.
- Citizens' solvency was guaranteed by mechanisms included in Florida law.

**Table 1**  
**Citizens Policy in Force Report**  
**As of December 31, 2009, 2010, and 2011**

Account	Policies In Force	Premiums With Surcharges	Exposure
<b>December 31, 2009</b>			
Personal-Residential (PLA)	609,652	\$ 842,465,329	\$ 122,185,402,117
Commercial (CLA)	9,126	247,265,773	51,156,466,955
High-risk/Coastal (HRA)	<u>410,436</u>	<u>1,038,957,086</u>	<u>232,648,760,272</u>
<b>Totals</b>	<b><u>1,029,214</u></b>	<b><u>\$ 2,128,688,188</u></b>	<b><u>\$ 405,990,629,344</u></b>
<b>December 31, 2010</b>			
Personal-Residential (PLA)	829,406	\$ 1,272,037,712	\$ 186,028,262,634
Commercial (CLA)	8,453	219,829,937	43,418,597,353
High-risk/Coastal (HRA)	<u>445,679</u>	<u>1,144,966,707</u>	<u>231,256,439,517</u>
<b>Totals</b>	<b><u>1,283,538</u></b>	<b><u>\$ 2,636,834,356</u></b>	<b><u>\$ 460,703,299,504</u></b>
<b>December 31, 2011</b>			
Personal-Residential (PLA)	1,003,856	\$ 1,666,972,921	\$ 241,179,431,560
Commercial (CLA)	8,374	207,061,686	40,585,211,026
High-risk/Coastal (HRA)	<u>460,161</u>	<u>1,197,823,136</u>	<u>228,910,478,327</u>
<b>Totals</b>	<b><u>1,472,391</u></b>	<b><u>\$ 3,071,857,743</u></b>	<b><u>\$ 510,675,120,913</u></b>

Source: Citizens

In general, the premium due from a Citizens' policyholder is derived by multiplying the insured value of the property by a premium rate and then reducing the result by any eligible wind mitigation credits. Pursuant to Section

<sup>2</sup> Citizens presentation to the Florida Senate's Banking and Insurance Committee on October 4, 2011.

<sup>3</sup> A captive agent is an insurance agent who, pursuant to the terms of his or her appointment, can write new policies for only one voluntary insurance company.

627.351(6)(n)4. through 6., Florida Statutes, premium rates for calendar years 2008 and 2009 were frozen to calendar year 2006 rates unless the 2007 rate filing was lower. Premium rates beginning on or after January 1, 2010, were limited to 10 percent annual increases, even if the application of actuarially determined rates indicated larger increases.

As shown in Table 2, Citizens’ actuarial estimates depicted a difference of approximately \$2,787 million (\$2.8 billion) between the premiums that would have been due using actuarially-determined rates and the premiums actually authorized for calendar years 2008 through 2011.<sup>4</sup>

**Table 2**  
**Premiums Foregone Due to Capping**  
**(Millions)**

Calendar Year	PLA/CLA	HRA	Total
2008	\$ (63)	\$ 196	\$ 133
2009	239	527	766
2010	307	437	744
2011	399	745	1,144
<b>Totals</b>	<b>\$ 882</b>	<b>\$ 1,905</b>	<b>\$ 2,787</b>

Source: Actuarial estimates provided by Citizens’ Chief Actuary

Section 627.351(6)(m), Florida Statutes, requires the Auditor General to conduct an operational audit of Citizens every three 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 and recommendations follow in succeeding paragraphs of the report. A detailed description of the work performed as part of our audit is included under the heading **OBJECTIVES, SCOPE, AND METHODOLOGY**.

**FINDINGS AND RECOMMENDATIONS**

**Underwriting**

Citizens’ Agent Appointment Agreement requires that agents, in accordance with the procedures established by Citizens, shall be responsible for assuring that all submitted applications are complete and accurate and in compliance with applicable application requirements for the requested coverage.

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

<sup>4</sup> In providing these estimates, Citizens’ Chief Actuary indicated that had the actuarially determined rates been used during 2008 through 2011, some policyholders may have obtained insurance in the private (voluntary) market, thus reducing the premium amounts estimated. However, no estimate was provided of how many policyholders would have gone into the private market and how much the estimated foregone premiums would have been reduced.

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**Finding No. 1: Determination of Premium Amounts**

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Our test of 38 applications for policies issued during the period January 2010 through April 2011, disclosed issues in 4 applications that led to the charging of incorrect premium amounts. Specifically:

- For two PLA applications, masonry construction was reported. However, our examination of photographs of the property disclosed the existence of frame construction. The misclassification of construction type resulted in the policyholders underpaying annual premiums and other assessments and surcharges by \$275 and \$312, respectively. The misclassification also led to premium errors in subsequent renewal periods.
- For one PLA application, the incorrect age of the home was reported. The home was actually constructed in 1969, although the application erroneously reported 1973 as the year of construction. The use of the incorrect year resulted in a \$192 underpayment of premium. The age of home information was corrected in the subsequent renewal period.
- For one PLA application, the roof type was reported as a hip roof when the property was actually constructed with a gable roof. The misclassification of roof type resulted in higher wind mitigation credits and lower premiums for the policy. As a consequence, the policyholder underpaid the annual premium and other assessments and surcharges by \$415. The incorrect roof type also led to premium errors in renewal periods.

The frequency and aggregation of the errors indicated that the application reviews made by Citizens had not been sufficiently thorough and effective. Absent detection of errors in the applications, incorrect underwriting decisions and premium calculations will be made and escape timely correction. Also, as indicated by Finding No. 4, policy data errors can adversely impact Citizens' depopulation efforts, as insurers may conclude there is a lack of reliable information upon which to make assessments of risk and premium sufficiency.

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**Recommendation:** We recommend that Citizens ensure that agents and underwriters properly evaluate all required documentation necessary to properly process applications for coverage and calculate the premiums due.

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**Finding No. 2: Square Footage Variances**

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Square-footage measurements are a major factor in the calculation of premium for a homeowner's policy, and in verifying square footage, information is obtained from various sources, including from the applicable county property appraiser's Web-accessible records. We found that Citizens' underwriting policies and procedures, with respect to the evaluation of reported square footage information, did not require the resolution of differences between the square footage shown on a policyholder application and the square footage shown by the county property appraiser's record, unless the square footage shown by the application was more than 40 percent greater, or 10 percent less than, the square footage shown by the county property appraiser's record.

While the underwriting function needs some flexibility in determining whether certain variations in square footage between the application and the county property appraiser's records are material, significant over-assessments of premium can result should the underwriter accept variances in which the square footage shown by the application is up to 40 percent greater than the square footage shown by county property appraiser records.

In response to our inquiries, Citizens has indicated that changes in the process for handling square footage variations were being considered.

**Recommendation:** We recommend that Citizens ensure that significant variances in square footage information be resolved during the underwriting process.

**Market Assistance Plan**

Section 627.3515, Florida Statutes, establishes the Market Assistance Plan (Plan) to assist in the placement of risks of applicants who have been unable to procure property or casualty insurance from authorized insurers, when such insurance is otherwise generally available from insurers authorized to transact and write that kind and class of insurance in this State. Pursuant to statute, each person serving as a member of Citizens’ Board of Governors also serves as a member of the Plan’s Board of Governors.

**Finding No. 3: Effectiveness of Market Assistance Plan**

The Plan provided a variety of programs for consumers, agents, and insurance companies. As shown by Table 3, during calendar years 2008 through 2011, the Plan provided agents with the names of approximately 68,600 customers who were trying to obtain property and casualty insurance, of which approximately 11,300 were placed with voluntary insurers. According to the Plan’s annual reports and other data, and as shown in Table 3, the Plan successfully placed 21.69 percent, 17.12 percent, 16.63 percent, and 10.88 percent of the requests received from prospective insureds during the years 2008, 2009, 2010, and 2011, respectively. There were 428 active agents participating in the Plan as of May 6, 2011.

Our audit disclosed that the Plan, while reasonably successful when employed, was significantly underutilized, as it was apparent that most of the applicants for Citizens’ policies had not submitted to the Plan requests for insurance. As shown by Table 3, we found that the 68,646 requests for coverage received by the Plan during the calendar years 2008 through 2011, represented less than 6 percent of the new personal residential policies written by Citizens during that period.

**Table 3  
Market Assistance Plan Placements**

Calendar Year	Voluntary Market Placements Through the Plan				New Personal Residential Policies Written	Percent Plan Requests to New Personal Residential Policies Written
	Number of Requests Through the Plan for the Year	Number of Placements Through the Plan for the Year	Percent Requests to Placements	Voluntary Market Placements (Millions)		
2008	18,966	4,113	21.69%	\$771	260,000 <sup>1</sup>	7.29%
2009	16,171	2,768	17.12%	591	257,000 <sup>1</sup>	6.29%
2010	14,024	2,332	16.63%	641	339,898	4.13%
2011	19,485	2,119	10.88%	558	451,711	4.31%
<b>Totals</b>	<b>68,646</b>	<b>11,332</b>	<b>16.51%</b>	<b>\$2,561</b>	<b>1,308,609</b>	<b>5.25%</b>

Note 1: Represents an estimate of new personal residential policies written by Citizens for that year.

Source: Prepared by Auditor General from various Citizens’ data files and reports.

While Citizens participated in various Market Assistance Plan promotional activities (for example, public service announcements, print and television outlets, etc.), additional opportunities exist to promote and increase the production of voluntary insurer placements. Specifically, promotional programs were generally not targeted at real

estate professionals, mortgage companies and brokers, and others involved in the sale of real estate. Such promotional activities may help to increase the number of plan requests and voluntary insurer placements.

Absent greater promotion and use of the Plan, the opportunity to place additional risks in the voluntary market may be lost.

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**Recommendation:** We recommend efforts to promote the Plan continue and that consideration be given to targeting promotional programs at those involved in the sale of real estate.

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### Take-Out Program

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

Citizens' files disclose that in calendar year 2008, take-outs peaked with approximately 385,000 policies and an exposure of approximately \$107 billion being assumed by take-out insurers. Table 4 below, summarizes the policies taken out during calendar years 2003 through 2011.

**Table 4**  
**Citizens Policy Take-Outs**  
**For Calendar Years 2003 Through 2011**

Calendar Year	PLA Policies	Exposure (000's)	Commercial and High-Risk Policies	Exposure (000's)	Total Policies	Total Exposure (000's)
2003	28,219	\$ 8,140,682	-	\$ -	28,219	\$ 8,140,682
2004	145,959	29,161,307	12,457	1,501,769	158,416	30,663,076
2005	218,128	40,174,893	75,556	13,483,947	293,684	53,658,840
2006	26,225	6,548,575	41,628	9,089,015	67,853	15,637,590
2007	247,887	68,259,426	-	-	247,887	68,259,426
2008	362,964	99,954,720	22,120	6,915,770	385,084	106,870,490
2009	132,803	34,092,310	16,842	3,692,197	149,645	37,784,507
2010	57,561	13,347,237	2,231	541,677	59,792	13,888,914
2011	45,827	10,742,168	7,750	1,315,715	53,577	12,057,883
<b>Totals</b>	<b>1,265,573</b>	<b>\$ 310,421,318</b>	<b>178,584</b>	<b>\$ 35,540,090</b>	<b>1,444,157</b>	<b>\$ 346,961,408</b>

Source: Citizens' Exposure Removed 2003-2012 Report.

To encourage insurers to take out policies, Section 627.3511(2), Florida Statutes, authorizes Citizens pay to an insurer a sum (bonus) of up to \$100 for each noncommercial residential risk taken-out.<sup>5</sup> To qualify for the bonus, the insurer's take-out plan must include a minimum of 25,000 policies. Section 627.3511(5), Florida Statutes, provides that if the policies taken-out are cancelled or not renewed by the insurer, the bonus amount is subject to proration for the time period the policies were insured.

<sup>5</sup> Section 627.3511(6), Florida Statutes, authorizes the payment of commercial residential take-out bonuses based on various factors, but the bonus may not exceed 25 percent of Citizens' annual year premium for the policy.

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**Finding No. 4: Barriers to Take-Outs**


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As shown in Table 4, take-outs peaked in calendar year 2008 and significantly decreased during the next three years. As part of our procedures to identify some of the reasons for these significant decreases, we contacted various insurers who had previously participated in the take-out programs.

Of the 17 different insurers who had taken policies out since March 1, 2008, 13 insurers were still in business and 4 (representing approximately 27 percent of take-out activity during that period) had been liquidated. We interviewed representatives of 9 insurers representing approximately 67 percent of the take-out activity during the period March 1, 2008, through December 31, 2011. The following are some of the barriers referenced by these insurers:

- Citizens' premium rates were viewed as being relatively low and voluntary insurers found it difficult to match those rates (4 of 9 insurers).
- Pursuant to Section 627.3517, Florida Statutes, the agents and the policyholders could opt-out of a take-out and that ability made it difficult for a voluntary insurer to take-out and retain policies (5 of 9 insurers).<sup>6</sup>
- The cost of reinsurance made the take-out of policies unprofitable, particularly if policyholders subsequently opted-out. (2 of 9 insurers).

As part of our review of the effectiveness of Citizens' take-out programs, we also noted that Citizens had surveyed insurance companies in an effort to identify barriers to depopulation.<sup>7</sup> Similar to the results shown above for our interviews, Citizens' summary of its survey identified as barriers Citizens' premium rates, the consumer choice law (Section 627.3517, Florida Statutes), and the costs and availability of reinsurance. In addition, Citizens' survey found that the following also adversely impacted the effectiveness of the depopulation programs:

- The amount of premium retained by Citizens to cover its expenses (ceded commissions) relative to the policies taken out was viewed by some insurers as a barrier to depopulation. To address this issue, Citizens eliminated the ceding of commissions, effective for any take-outs during the fourth quarter of calendar year 2011 forward.
- Citizens' underwriting guidelines sometimes differed from those of other insurance companies, thereby creating difficulties in evaluating policies for take-out.
- Some insurers noted that Citizens' policy systems sometimes contained incorrect policy data, which could lead insurance companies to take on additional risk that was not anticipated, as well as calculate premium amounts that were inadequate for the actual risk covered.

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**Recommendation:** Based on the above information, actions that could enhance the effectiveness of depopulation efforts include:

- **As Citizens' premium rates increase, as scheduled by Section 627.351(6)(n)6., Florida Statutes, the premium rates offered by voluntary insurers may become a more attractive alternative for Citizens' policyholders, as long as voluntary insurer rates are not similarly increased.**
- **Changes to Section 627.3517, Florida Statutes, to further limit the ability of a Citizens' policyholder or policyholder's agent to opt-out of a take-out offer, may also contribute to an increase the effectiveness of the take-out program. For example, that statute could be amended to require that, if**

<sup>6</sup> For the period March 1, 2008, through December 31, 2010, Citizens' records indicate that there were 128,595 opt-outs due to agent declinations; 142,818 opt-outs due to pre-assumption declines by policyholders; and 105,095 post-assumption declines by policyholders. The number of opt-outs calculated may include duplicates in those instances in which the same policyholder was selected for more than one take-out.

<sup>7</sup> Depopulation Survey Executive Summary, presented at the February 22, 2012, Citizens Depopulation Committee meeting.

an agent is unwilling or unable to accept an appointment from a take-out insurer, then the policyholder must engage an agent of the take-out insurer.

- Citizens' personnel indicated that a collaborative effort was planned for the conduct of a policy data validation review. The completion of such a review and any indicated corrective measures may contribute to an increase in insurer interest in the take-out of Citizens policies.

#### **Finding No. 5: Take-Out Bonus Overpayment**

Effective June 30, 2006, Citizens entered into a PLA Three Year Bonus Assumption Agreement (Assumption Agreement) with a take-out insurance company (TOIC). This agreement covered the individual three-year bonus take-outs initiated between Citizens and TOIC for the period June 30, 2006, through December 31, 2008. During that timeframe, Citizens and TOIC entered into seven different take-outs removing 37,947 policies from Citizens, resulting in a gross bonus of \$9,180,296.<sup>8</sup>

Citizens paid the bonus through an escrow account with monthly amortization of the bonus amount over a three-year time period. At the end of the three-year time period, an independent accounting firm was to be engaged to determine for a sample of active and cancelled take-out policies, whether the TOIC properly classified the policies as eligible for the bonus.<sup>9</sup>

Following the receipt of the independent accounting firm's report, Citizens determined that the bonus amount to be paid to the TOIC totaled \$7,271,864. As part of our audit, we reviewed the calculation and payment of the bonus amount to the TOIC. Our review of the bonus calculation disclosed that in calculating the bonus amount, Citizens did not include a proration adjustment. Exhibit B to the Assumption Agreement indicated that for any eligible policy which cancels for a valid reason, the bonus or additional bonus was to be paid on a pro-rata basis corresponding with the time the policy was in-force with the assuming insurer.

In response to our audit inquiry, Citizens responded that a proration adjustment should have been made for the policies cancelled for valid reasons prior to the end of the three-year time period and determined that the proration amount that should have been recovered from the TOIC totaled \$2,584,438. Subsequent to our inquiry, Citizens recovered the adjustment amount.

**Recommendation:** We recommend for any future bonus assumptions that Citizens ensure the consideration of all factors that may affect the calculation of the bonus.

#### **Customer Service**

Section 627.351(6)(a), Florida Statutes, provides, in part, that it is the intent of the Legislature that Citizens provide service to policyholders, applicants, and agents which is of no less than the quality generally provided in the voluntary market. As part of our audit, we evaluated Citizens' customer service function, and as part of our evaluation, we

<sup>8</sup> According to Citizens' management, this was the only assumption agreement which included the proration requirement, and none of the assumption agreements executed subsequent to the date of this agreement provided for the payment of bonuses.

<sup>9</sup> Pursuant to the assumption agreement, cancellations can be classified as either valid (bonus eligible) or invalid (bonus ineligible). Valid cancellations include those cancelled because of nonpayment of premium or at the initiation of the policyholder. Invalid cancellations are all insurer-initiated cancellations, excluding those resulting from cancellation because of nonpayment of premium.

surveyed a sample of policy holders, analyzed complaint data maintained by the Department of Financial Services (DFS), and surveyed a sample of agents appointed by Citizens. As described in more detail in Finding No. 6, the surveys of customers and agents indicated that, in general, most customers and agents were satisfied with the level of customer and agent service and support. Our analysis of complaint data maintained by DFS indicated that Citizens’ complaint experience was similar to that of other large Florida property and casualty insurers.

**Finding No. 6: Customer 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 on May 20, 2011, to 1,000 policyholders who had policies in effect at some point during the period January 2010 through April 2011, including 500 who had claims that were closed during that same period. Questions were included in the survey to address customer satisfaction with services relating to policy issuance, policy renewal, and claims handling. We also included questions to measure policyholder satisfaction with the services provided by Citizens’ agents, Citizens’ customer service, and overall satisfaction with their insurance policies. We received 243 policyholder responses to our survey. Our evaluation of the results for all surveyed policyholders, as shown by Table 5, indicated that most policyholders were satisfied with the services received from Citizens and Citizens’ agents. In comparison to the measurements of customer service satisfaction reported in audit report No. 2009-102, the percentage of satisfied to very satisfied policyholders increased for the various customer service categories, except for call center operations, for which we noted a relatively small decline in policyholder satisfaction.

**Table 5  
Customer Service Survey**

	Very Dissatisfied to Dissatisfied		Satisfied to Very Satisfied		Total Responses <sup>1</sup>
	Number	Percentage	Number	Percentage	
Policy Issuance and Coverage	26	11%	204	89%	230
Policy Renewal	16	8%	178	92%	194
Insurance Agent Satisfaction	6	4%	154	96%	160
Call Center Operations	20	22%	70	78%	90
Claims Handling	20	24%	65	76%	85
<b>Overall</b>	<b>33</b>	<b>14%</b>	<b>202</b>	<b>86%</b>	<b>235</b>

<sup>1</sup> Not all 243 policyholders responded to every question.

Source: Policyholder surveys.

*Complaints*

As part of our audit of Citizens’ customer service function, we analyzed Department of Financial Services (DFS), Division of Consumer Services, data available for the period January 1, 2010, through December 31, 2011, to identify any indications of significant customer service issues. As shown in Table 6, we found that during this period, Citizens ranked fourth among the top 11 Florida residential, commercial, and other property and casualty insurers in terms of the number of complaints as a percentage of policies in force as of September 30, 2011. The number of complaints and the frequency of the complaints significantly decreased for Citizens as compared to the Complaints as a Percentage of Policies in Force at September 30, 2007, table reported in Report No. 2009-102.

**Table 6**  
**Complaints as Percentage of Policies in Force as of September 30, 2011**

Company Ranking	Company	Complaints as a Percentage of Policies in Force	Complaints for the Period January 1, 2010, through December 31, 2011	Policies in Force at September 30, 2011
1	1	0.271%	1,574	581,579
2	2	0.265%	364	137,197
3	3	0.239%	1,227	514,350
4	<b>Citizens</b>	0.238%	3,403	1,432,387
5	4	0.237%	308	130,174
6	5	0.210%	367	175,196
7	6	0.181%	187	103,254
8	7	0.168%	173	102,715
9	8	0.112%	150	134,042
10	9	0.058%	67	116,506
11	10	0.015%	22	144,486

Note: Closed complaints for which the company or agent position was upheld, complaints that did not include sufficient information, and complaints that were withdrawn have been excluded from the complaint totals.

Source: Prepared by the Auditor General from data provided by the OIR and the Department of Financial Services. Evaluation of data consisted of comparisons of prior period data to that reported in the current period and comparisons of the number of complaints shown by Citizens' records to the number shown by Department data pertaining to the same period.

#### 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 its agents have the necessary resources to cost-effectively serve policyholders including adequate training, the availability of policyholder information electronically, and consistent support from Citizens' underwriting, claims, and other staff. To measure agent satisfaction with the resources made available by Citizens and to identify potential areas where Citizens could enhance its operations with respect to its appointed agents, we mailed surveys on June 13, 2011, to 700 appointed agents.<sup>10</sup> Questions were included in the survey to gauge agent satisfaction with, among other things, Citizens' training program, its primary electronic policy administration systems (ePAS, eDOCS, and the Agency Link [Commercial Policyholder Information]), service provided by Citizens' staff, and overall satisfaction with Citizens' agent support. Our evaluation of the survey results, as shown by Table 7, indicated that most agents were satisfied with Citizens' operations. Our prior audit disclosed similar levels of agent satisfaction.

<sup>10</sup> As of the date of selection of the 700 agents, Citizens had appointed approximately 8,200 agents.

**Table 7**  
**Appointed Agent Survey**

	Very Dissatisfied to Dissatisfied		Satisfied to Very Satisfied		Total Responses <sup>1</sup>
	Number	Percentage	Number	Percentage	
Agency Certification Program	12	9%	122	91%	134
Training	18	13%	119	87%	137
ePAS	8	6%	122	94%	130
eDOCS	11	9%	117	91%	128
Agency Link (Commercial Policyholder Information)	7	8%	78	92%	85
New Policy Issuance	29	21%	107	79%	137
Policy Renewal	15	11%	120	89%	135
Service	21	15%	105	85%	136
Claims Handling	8	9%	80	91%	88
<b>Overall Agency Support</b>	<b>16</b>	<b>12%</b>	<b>119</b>	<b>88%</b>	<b>135</b>

<sup>1</sup> Not all 138 appointed agents responded to every question.

Source: Appointed Agent surveys.

**Recommendation:** We recommend that Citizens continue its efforts to provide customer service which is no less than the quality generally provided in the voluntary market.

**Claims Handling**

Citizens’ Claims Division was organized into multiple teams to facilitate both field and desk adjustments. Citizens had established claims teams for residential and commercial lines and for specialized claim types such as those relating to sinkholes. Claims’ staff were supported by a Special Investigation Unit (SIU), a Dispute Unit, and a Recovery Team.<sup>11</sup> Additionally, Citizens augmented claims staffing as necessary by utilizing independent adjusters 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 had also established an enterprise wide quality assurance program with a unit dedicated to reviewing claims to ensure that claims were processed in accordance with Citizens’ best practices and guidelines.

Citizens had promulgated written policies and guidelines to ensure claims were processed in accordance with industry best practices including timely documentation of:

- Verification of coverage, including applicable deductibles, and identification of pre-existing damage.
- Losses to structure, contents, and additional living expenses, as applicable.
- Retention of experts where appropriate.
- Provision of damage estimates to policyholders.
- Establishment of timely, accurate reserves to cover claim(s).

To determine whether Citizens was in compliance with its approved guidelines and industry best practices, we examined 202 claim files closed during the period January 7, 2010, through May 9, 2011, totaling \$13,579,088

<sup>11</sup> The Recovery Team is a specialized unit within Citizens’ claims management function that receives and investigates claim referred by claims adjusters for potential subrogation. The Dispute Unit is a specialized unit within Citizens’ claims management function that receives and administers claims in which a demand for appraisal has been made.

indemnity paid. Our claims sample included 40 claims related to sinkhole damages with total indemnity paid of \$6,512,838, and 40 claims involving public adjusters (adjusters representing policyholders) with total indemnity paid of \$2,375,189. To assist in our review we obtained the services of an insurance claims consultant.

### **Finding No. 7: Claim Adjustment and Payment**

Generally, Citizens processed the sampled claims in accordance with its written guidelines and industry best practices. However, as similarly noted in audit report Nos. 2006-096 and 2009-102, Citizens did not perform an insurance-to-value analysis at the time of loss adjustment, a step that must be taken in order to enforce the 80 percent co-insurance clause included in various policies issued by Citizens. Such an analysis helps ensure the property is appropriately insured at an amount commensurate with the property's replacement cost. Should the analysis show that a property's value, as shown by the policy, is less than 80 percent of the property's estimated replacement cost, Citizens, then pursuant to policy loss settlement provisions, may become responsible for a smaller portion of the claim.

Our audit tests disclosed that for 94 of 108 applicable claims, no insurance-to-value calculation was performed. In response to our inquiries, Citizens' management indicated that Citizens was continuing to move toward a process that would include completion of an insurance-to-value calculation and the application of the co-insurance clause and that it has started performing insurance-to-value calculations on some claims.

The performance of insurance-to-value analyses will allow Citizens to enforce policy co-insurance clauses and pay claims on a pro-rata basis when the amount insured is less than 80 percent of replacement cost.

**Recommendation:** We recommend Citizens continue implementation of insurance-to-value calculations and application of co-insurance penalties, where applicable.

### **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>12</sup> In meeting this responsibility, Citizens utilizes modeling to predict a worst case scenario storm and the resulting losses that would be incurred by Citizens, given its policy commitments. These modeling processes yield two 100-year PMLs, one for the risks accounted for within the PLA and CLA, and one for the risks accounted for within the HRA. At December 31, 2011, the estimated 100-year PMLs for the PLA/CLA and HRA were \$9.16 billion and \$14.9 billion, respectively.

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

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

<sup>12</sup> A 1-in-100 year storm is defined as a storm having a 1 percent (1/100) chance of occurrence in any year.

At December 31, 2011, Citizens had estimated a surplus of approximately \$3.2 billion available to pay claims for the PLA/CLA which represented approximately 35 percent of the 100-year PML. According to Citizens, this amount of surplus would provide sufficient liquid resources to pay claims until FHCF reimbursements (\$3.04 billion) became available.

At December 31, 2011, Citizens had estimated a surplus of approximately \$3 billion to pay claims for the HRA, representing 20 percent of the 100-year PML. FHCF reimbursement available totaled \$4.114 billion.

Claims in excess of available surplus and FHCF reinsurance will be covered through private reinsurance, policyholder surcharges, and assessments. In the event of a 100-year storm, as of December 31, 2011, the amounts that would be required from such sources were estimated to be \$2.9 billion for PLA/CLA claims and \$7.8 billion for HRA claims.

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**Finding No. 8: HRA Liquidity Financing**

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In order to have sufficient cash on hand to pay HRA account catastrophic losses, Citizens has provided for liquidity through the issuance of pre-event bonds (bonds issued in anticipation of storm events). Because the cash must be available to pay claims when needed, a primary goal must be the maintenance of the safety and liquidity of the proceeds through conservative investment. There is also, however, a need to minimize the cost of carrying the debt (cost-of-carry). The cost-of-carry is defined as the difference between the interest expense accruing on the debt and the investment earnings accruing on the proceeds while they are available for investment. The cost-of-carry can be minimized over the life of the debt by initially structuring the debt issue such that the interest rate on the debt is matched as closely as possible to expected rates of return on conservatively invested proceeds. Our review of the effectiveness of the steps taken by Citizens to maintain the safety and liquidity of the invested proceeds and to minimize the cost-of-carry disclosed that Citizens issued pre-event debt and paid issuance costs at rates not considered excessive and had earnings that appeared reasonable based upon the safety and liquidity criteria in its investment policy. During the period July 2008 through December 2011, the cost of providing the HRA with additional liquidity of \$3.8 billion (amount outstanding at December 31, 2011) to pay potential claims in the event of a catastrophic event was approximately \$353 million as shown in Table 8.

**Table 8**  
**Comparison of Bond Interest Expense and Earnings on Investment of Bond Proceeds**  
**From July 2008 Through December 2011**

Bond Issue	Par Value of Bonds	Par Value of Bonds at December 31, 2011	Interest Earnings	Interest Expense	Issuance Costs and Underwriters Discount	Cost of Carry Adjusted for Issuance Costs and Underwriters Discount
HRA2008A	\$1,750,000,000	\$ 0	\$ 24,922,044	\$ 78,763,836	\$ 6,865,734	\$ (60,707,526)
HRA2009A	1,646,000,000	1,021,000,000	17,278,592	163,939,625	12,047,196	(158,708,229)
HRA2010A	2,400,000,000	1,900,000,000	27,732,713	128,218,044	15,592,685	(116,078,016)
HRA2011A	900,000,000	900,000,000	2,768,363	14,479,725	6,004,499	(17,715,861)
<b>Totals</b>	<b>\$6,696,000,000</b>	<b>\$3,821,000,000</b>	<b>\$ 72,701,712</b>	<b>\$ 385,401,230</b>	<b>\$ 40,510,114</b>	<b>\$(353,209,632)</b>

Source: Citizens

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 Section 627.351(6)(n), Florida Statutes, the premiums collected become more consistent with those that would be calculated using actuarially-determined rates. For example, as shown in Table 2, the use of actuarially-determined rates may have produced additional HRA premiums of up to \$1.9 billion for the period January 1, 2008, through December 31, 2011. 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 continue its efforts to reduce the cost-of-carry on any pre-event financing while maintaining the safety and liquidity of the financing proceeds through conservative investment. We also recommend that, to the fullest extent authorized, Citizens collect premiums based upon actuarially-determined rates.

**Procurement**

**Finding No. 9: Emergency and Sole Source Procurement Practices**

Citizens’ procurement is governed by Section 627.351(6)(e), Florida Statutes, which states that purchases which equal or exceed \$2,500, but are less than \$25,000, shall be made by receipt of written quotes, written record of telephone quotes, or informal bids, whenever practical. The procurement of goods or services valued at over \$25,000, shall be subject to competitive solicitation, except in situations where the goods or services are provided from a sole source or are deemed an emergency purchase, the services are exempted from competitive solicitation requirements under Section 287.057(3)(f), Florida Statutes, or the procurement of services involves the sale of bonds pursuant to Section 627.3513, Florida Statutes. Section 627.351(6)(e), Florida Statutes, also requires that the justification for sole source or emergency procurement be documented. Effective April 2008, Citizens’ procurement policy allowed for emergency and sole source purchases, as shown below:

- Under the April 2008 procurement policy, an emergency purchase was permitted to obtain goods and services in the event of a catastrophe situation, a disruption or interruption of essential services, or when the time required to issue a competitive solicitation would be detrimental to the interests of Citizens. The emergency purchase required the approval of the Senior Vice-President or higher. Effective April 2010, the emergency purchase policy was amended to allow emergency procurement when the time required for competitive procurement

would be detrimental to the material interests of Citizens and its policyholders and to require approval of the President and, when practical, the Chair of the Board of Governors.

- Under the April 2008 procurement policy, a sole source purchase could be authorized when goods or services were available from only one source or the provider of the services was uniquely qualified as determined by an analysis of the marketplace. A sole source procurement required the approval of the Director of Purchasing and General Services (Director). Effective April 2010, the policy was revised to permit a sole source purchase only when the required goods or services were available from only one supplier; or the purchase will continue or expand an imbedded technology system or service already in use by Citizens, provided the continuation or expansion can be justified by the applicable business unit.

Subsequently, in August 2010, the Chief Financial Officer (CFO) and the President of the Florida Senate requested Citizens implement additional contract reforms to ensure accountable and competitive contracting. Effective January 2011, Citizens' procurement policy was amended with respect to emergency and sole source purchases to require additional scrutiny of such proposed purchases and a higher level of approval, as follows:

- Emergency purchases are allowed when the President, in consultation with the Chair or Vice Chair of the Board, determines in writing that an immediate danger to the public health, safety, or welfare or other immediate and substantial loss to Citizens or its policyholders requires emergency action. Under such circumstances, Citizens, whenever practicable, is to obtain pricing information from at least two prospective vendors, which will be retained in the contract file. Citizens is also to provide a report of any emergency procurement to the Board of Governors at its next scheduled meeting. An emergency purchase of goods or services shall be limited to the scope and time required to meet interim needs and complete a competitive solicitation process and transition time, if necessary.
- Sole source purchases are allowed when an analysis of the marketplace for the good or service is conducted by Citizens, and Citizens determines in writing that the required good or service is available from only one supplier, or is necessary or unique, for example, where the deliverable is copyrighted, patented or proprietary, or where there is an absence of competition or providers in the marketplace. When Citizens reasonably determines that goods or services qualify as a sole source purchase, Citizens shall post on its Web site a description of the goods or services sought for a period of at least seven (7) business days. The description must include a request that prospective vendors provide information regarding their ability to supply the goods or services described. If it is determined in writing by Citizens, after reviewing any information received from prospective vendors, that the goods or services qualify as a sole source purchase, Citizens will notify the vendor(s) and proceed with the purchase. A sole source procurement will be discontinued and a competitive solicitation instituted when written information is timely received which demonstrates that additional prospective vendors can supply the goods or services sought.

The changes in procurement policy have contributed to a decline in the number of sole source and emergency contracts procured. In a September 3, 2010, response to the Senate President, Citizens indicated that from January 2008 through July 2010, Citizens entered into 40 sole source contracts and 47 emergency contracts estimated to cost more than \$25,000. Subsequent to July 2010, and through November 17, 2011, the number of contracts that were considered sole source procurements decreased to 19 and were primarily related to software licenses or maintenance agreements for existing software. No contracts were in effect which had been procured as emergency procurements.

As part of our audit, we tested 10 contracts, with estimated costs totaling \$9,576,868 that Citizens had awarded during the period January 2010 through June 2011. We judgmentally selected the contracts and included in our test, contracts that were competitively awarded and those which had been awarded as emergency or sole source procurements. Our audit indicated that for the contracts tested, the procurements were made in accordance with the procedures in place at the time of procurement; the receipt of the required goods and services was documented; and the contractors were appropriately monitored.

**Recommendation:** We recommend that Citizens continue to emphasize the use of competitive procurement methods.

### Information Technology Controls

In order to accomplish the mission and objectives of Citizens, several informational technology application systems have been contracted for or developed. These systems include, but are not limited to:

- *ePAS* – A browser-based policy and claims processing system, which processed PLA policy and claim transactions.
- *Wind* – The HRA residential and commercial policy system, which included claims and accounting functionality.
- *CSC Point* – An AS400-based commercial residential multi-peril policy system.
- *Claims Tracking System (CTS)* – The daily and catastrophe claims tracking and adjuster management system.
- *Agency Link* – A system available for agents to view detailed policy and payment information about commercial multiperil policies.
- *Agent Appointment System (AAS)* – A browser-based system used by agents applying for appointment to write Citizens policies.
- *Claims Administration Information System (CAIS)* – An internally developed Web-based system that was used for credentialing of adjusters.
- *ImageRight* – A document management system tailored for use in the insurance industry.

### Finding No. 10: Termination of User Access

Effective security controls include provisions to timely disable employee access privileges to information and data when employment termination occurs. Prompt action is necessary to ensure that a former employee's access privileges are not misused by the former employee or others.

Citizens had implemented procedures to remove the access privileges of employees who terminated employment. Under the procedures, access for voluntarily departing employees was to be revoked upon termination, unless the Citizens Information Security Department (CISD) recommended otherwise. Such procedures required that user management submit a User Access Management (UAM) form to CISD identifying the specific applications for which access privileges were to be disabled. Upon receipt of notification, CISD was to disable access privileges to those applications. Additionally, CISD had implemented a process, Computer Access Management (CAM), to identify applications that had not been accessed by a user during the preceding 30 days. For such applications, a request was to be sent to user management indicating that the user had not logged on for 30 days and inquiring whether the access privileges should be disabled. If no response was received, CISD's procedure was to terminate access after 60 days of inactivity.

Our tests disclosed that, in some instances, the established security procedures had not effectively ensured timely termination of user access. Tests of the timeliness of termination of the access privileges for 209 employees who terminated during the period January 1, 2010, through June 14, 2011, disclosed:

- For 11 employees, access privileges to various applications (CAIS, CTS, ePAS, and Wind) were not timely terminated due to user management not marking on the UAM form the space provided for the application. Access privileges were subsequently removed on dates ranging from 6 days to 169 days after termination. For 1 of these 11 employees, user management had marked ePAS and Wind access privileges for termination, but

CISD did not terminate the access. For this employee, access privileges were subsequently disabled 133 days after termination.

- For 2 employees, access privileges to AAS were not timely terminated because the UAM form did not make provision for the AAS application. Access privileges for the 2 employees were subsequently disabled 111 and 115 days, respectively, after termination.
- For 1 employee, user management did not submit a UAM form requesting disabling of CAIS access privileges. Access privileges were disabled 158 days subsequent to termination.

The CAM process, due to its manual nature, did not result in the disabling of the user access privileges as the control was intended. CISD stated that until May 2011, CAM reporting for CAIS, CTS and Wind had been ad hoc. As of May 2011, consistent reporting became available for all systems.

In response to our inquiries, CISD has indicated that security awareness training will include reinforcement that user managers are responsible for the control of access to their applicable application systems and accountable for ensuring the security of data. CISD also indicated that the UAM form will be enhanced to include all major applications.

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**Recommendation:**      **We recommend that Citizens ensure that access privileges are timely disabled.**

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### **Finding No. 11: Other Security Controls**

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Security controls are intended to ensure the confidentiality, integrity, and availability of data and protect information technology (IT) resources. Our audit disclosed certain security control deficiencies related to Citizens' IT systems, in addition to the user access control issues disclosed in Finding No. 10. We are not disclosing specific details of these other security control issues in this report to avoid the possibility of compromising Citizens' data and IT resources. However, we have notified appropriate management of the specific issues.

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

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

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In our report No. 2009-102, finding No. 1, we recommended that Citizens continue its implementation of an enterprise risk management (ERM) function. In response, Citizens created an enterprise risk management organizational unit that administratively reports to the Chief Financial Officer and functionally reports to the Risk and Loss Prevention Committee.<sup>13</sup> To implement the ERM function, Citizens has established various governing documents, including but not limited to, a risk profile statement and ERM strategic and tactical implementation plans.

Citizens has conducted two ERM pilot projects that were used to modify and improve its ERM process. While Citizens stated that its plan is to continuously apply the ERM processes to all programs, activities and functions, the first cycle was not scheduled to be finished until after our scheduled report date. Therefore, we were unable to determine whether Citizens' ERM function processes and procedures were in place and operating effectively. These processes and procedures will be reviewed during subsequent audits.

<sup>13</sup> The Risk and Loss Prevention Committee is comprised of Citizens' President and Chief Executive Officer, Chief Financial Officer, Chief of Internal Audit, and General Counsel.

Except as discussed in the preceding paragraphs, Citizens had taken corrective actions for the findings included in our report No. 2009-102.

### OBJECTIVES, SCOPE, AND METHODOLOGY

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

We conducted this operational audit during period beginning in January 2011 and ending in December 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

This operational audit focused on information technology controls, enterprise risk management, agent appointments, procurement, customer service, claims handling, take-out programs and bonuses, underwriting and eligibility, and financing arrangements. The overall objectives of the audit were.

- To evaluate the effectiveness of established internal controls in achieving management's control objectives in the categories of compliance with controlling laws, administrative rules, and other guidelines; the economic, efficient, and effective operation of Citizens; the relevance and reliability of records and reports; and the safeguarding of assets.
- To evaluate management's performance in achieving compliance with controlling laws, administrative rules, and other guidelines; the economic, efficient, and effective operation of Citizens; the relevance and reliability of records and reports; and the safeguarding of assets.
- To determine whether management had corrected, or was in the process of correcting, all applicable deficiencies disclosed in audit report No. 2009-102.
- To identify statutory and fiscal changes that may be recommended to the Legislature pursuant to Section 11.45(7)(h), Florida Statutes.

In conducting our audit we:

- Examined 10 contracts with estimated costs over \$25,000 and awarded during the period January 1, 2010, through June 2, 2011, to determine whether they were procured in accordance with Citizens' policies and procedures, the goods and services were received, the contracts were monitored, and the contract payments were in accordance with the terms of the contract.
- Selected 27 employees, senior managers, and Board members to determine whether conflict of interest forms and code of ethics forms, as applicable, were appropriately filed.
- With respect to the execution of the leases for office space, determined Citizens' compliance with Chapter 255, Florida Statutes.
- Examined 10 customer service monitoring reports prepared by Citizens.
- To assist in the measurement of policyholder satisfaction, surveyed 500 policyholders selected from Citizens' policyholder systems and 500 policyholders selected from those referenced in the claims tracking system.
- To measure appointed agent satisfaction with Citizens' services, surveyed 700 agents who held a Citizens' appointment as of April 6, 2011.

- Examined 30 complaints from the population of all complaints received from January 1, 2010, through December 31, 2010, and determined whether Citizens had taken adequate actions to resolve the complaint.
- Performed analytical procedures to compare Department of Financial Services' complaint data from March 2008 through August 2009 to that of September 2009 through February 2011.
- Performed analytical procedures to compare the number of complaints reported by the Department of Financial Services to the number of complaints reported by Citizens for the period March 2008 through April 2011.
- Using Department of Financial Services complaint data, performed analytical procedures to compare the type and frequency of consumer complaints lodged against Citizens to complaints lodged against other insurers.
- Examined 202 claims, including 40 sinkhole and 40 public adjuster claims, closed during the period January 2010 through May 2011, 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, inspections, and observations to determine whether Citizens had designed and established a catastrophe response plan.
- Examined 1 of 15 assumptions (take-outs) executed during the period January 1, 2010, through January 11, 2011, to determine whether the assumption was conducted in accordance with Sections 627.351(6)(q) and 627.3511, Florida Statutes, and Citizens' policies and procedures.
- Examined one of five depopulation bonus payments paid during the period January 1, 2010, through December 31, 2010, and the escrow deposits made to fund the bonus payment to determine whether the bonus payment and escrow deposit were calculated in accordance with the assumption agreement, governing law, and Citizens' policies and procedures.
- Performed inquiries, inspections, and observations to determine whether the Florida Market Assistance Plan was being promoted and utilized in assisting consumers in their search for property and casualty insurance in the voluntary market.
- Examined 38 new policies issued during the period January 1, 2010, through April 30, 2011, to determine that policyholders were eligible for a Citizens' policy, appropriate underwriting criteria were applied, and the premium was correctly calculated.
- Obtained an understanding of Citizens' wind mitigation reinspection program.
- Examined all financing arrangements entered into during the period to January 1, 2009, through June 30, 2011, 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.
- Performed inquiries, inspections, and observations, to determine whether Citizens had appropriately procured its external investment managers.
- Performed inquiries, inspections, and observations, to determine whether Citizens had appropriately monitored its external investment managers.
- Performed analytical procedures to determine whether Citizens received emergency assessments from all applicable insurers for the 2010 calendar year.
- Obtained an understanding of IT controls, assessed control risk, evaluated whether selected general and application IT controls were in place, and tested the effectiveness of the controls.
- Communicated on an interim basis with applicable Citizens' management 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.

**AUTHORITY**

Section 627.351(6)(m), Florida Statutes, requires that the Auditor General conduct an operational audit of Citizens Property Insurance Corporation every three years. Pursuant to the provisions of Section 11.45, Florida Statutes, I have directed that this report be prepared to present the results of our operational audit.



David W. Martin, CPA  
Auditor General

**MANAGEMENT'S RESPONSE**

In a response letter dated August 24, 2012 the President and Executive Director of Citizens Property Insurance Corporation provided a response to our audit findings and recommendations. The President and Executive Director's response is included as **EXHIBIT A**.

**EXHIBIT A  
MANAGEMENT'S RESPONSE**

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

TELEPHONE: (850) 513-3700 FAX: (850) 513-3903



August 24, 2012

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

Dear Mr. Martin:

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 25, 2012.

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

BG/bw

Enclosure

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Carlos A. Lacasa, Chairman, Miami-Dade County  
Nancy Baily, Vice Chair, Hillsborough County • Carol Everhart, Pinellas County • Chris Gardner, Orange County  
Don Glisson, Jr., Duval County • Tom Lynch, Palm Beach County • John Rollins, Alachua County  
John Wortman, St. Johns County • Barry Gilway, President/CEO and Executive Director

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**Finding No. 1: Determination of Premium Amounts**

Our test of 38 applications for policies issued during the period January 2010 through April 2011, disclosed issues in 4 applications that led to the charging of incorrect premium amounts. Specifically:

- For two PLA applications, masonry construction was reported. However, our examination of photographs of the property disclosed the existence of frame construction. The misclassification of construction type resulted in the policyholders underpaying annual premiums and other assessments and surcharges by \$275 and \$312, respectively. The misclassification also led to premium errors in subsequent renewal periods.
- For one PLA application, the incorrect age of the home was reported. The home was actually constructed in 1969, although the application erroneously reported 1973 as the year of construction. The use of the incorrect year resulted in a \$192 underpayment of premium. The age of home information was corrected in the subsequent renewal period.
- For one PLA application, the roof type was reported as a hip roof when the property was actually constructed with a gable roof. The misclassification of roof type resulted in higher wind mitigation credits and lower premiums for the policy. As a consequence, the policyholder underpaid the annual premium and other assessments and surcharges by \$415. The incorrect roof type also led to premium errors in renewal periods.

The frequency and aggregation of the errors indicated that the application reviews made by Citizens had not been sufficiently thorough and effective. Absent detection of errors in the applications, incorrect underwriting decisions and premium calculations will be made and escape timely correction. Also, as indicated by Finding No. 4, policy data errors can adversely impact Citizens' depopulation efforts, as insurers may conclude there is a lack of reliable information upon which to make assessments of risk and premium sufficiency.

**Recommendation: We recommend that Citizens ensure that agents and underwriters properly evaluate all required documentation necessary to properly process applications for coverage and calculate the premiums due.**

Citizens agrees that it is essential to have accurate information that is properly evaluated in order to ensure the accuracy of coverage and premiums due. Toward that end, the following enhancements are being initiated:

In April 2012, a new Quality Assurance process was introduced which focuses on the quality of decision making and accuracy of rating factors. Previously, the process had a more procedural focus. This new process includes a monthly random sampling of each Citizens and third party vendor employee's work. In addition to formal Quality Assurance Team's reviews, each employee's Supervisor randomly checks additional transactions each month. The Personal Lines Management team also holds monthly group meetings to listen to randomly selected phone calls to evaluate the handling, professionalism and accuracy of responses.

Additionally, Training Department staffing has been increased to develop and deliver a new Underwriting Training Class which consists of a 7 week program for new hires. Parts of that curriculum are also being disseminated to all underwriters as refresher training.

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Finally, an Underwriting Consultant and a Technical Underwriting Specialist position were added. These two new positions are focused on developing more complete procedural instructions for staff in order to improve the quality and consistency of handling, and to identify ongoing training opportunities.

**Finding No. 2: Square Footage Variances**

Square-footage measurements are a major factor in the calculation of premium for a homeowner's policy, and in verifying square footage, information is obtained from various sources, including from the applicable county property appraiser's Web-accessible records. We found that Citizens' underwriting policies and procedures, with respect to the evaluation of reported square footage information, did not require the resolution of differences between the square footage shown on a policyholder application and the square footage shown by the county property appraiser's record, unless the square footage shown by the application was more than 40 percent greater, or 10 percent less than, the square footage shown by the county property appraiser's record.

While the underwriting function needs some flexibility in determining whether certain variations in square footage between the application and the county property appraiser's records are material, significant over-assessments of premium can result should the underwriter accept variances in which the square footage shown by the application is up to 40 percent greater than the square footage shown by county property appraiser records.

In response to our inquiries, Citizens has indicated that changes in the process for handling square footage variations were being considered.

**Recommendation: We recommend that Citizens ensure that significant variances in square footage information be resolved during the underwriting process.**

Citizens recently revised its procedures regarding the verification of square footage and now allows only a 10% variance (plus or minus) from the Property Appraiser's website information. Any variances outside of those guidelines have to be substantiated by the agent, with receipts or plans showing proof of home modifications.

**Finding No. 3: Effectiveness of Market Assistance Plan**

The Plan provided a variety of programs for consumers, agents, and insurance companies. As shown by Table 3, during calendar years 2008 through 2011, the Plan provided agents with the names of approximately 68,600 customers who were trying to obtain property and casualty insurance, of which approximately 11,300 were placed with voluntary insurers. According to the Plan's annual reports and other data, and as shown in Table 3, the Plan successfully placed 21.69 percent, 17.12 percent, 16.63 percent, and 10.88 percent of the requests received from prospective insureds during the years 2008, 2009, 2010, and 2011, respectively. There were 428 active agents participating in the Plan as of May 6, 2011.

Our audit disclosed that the Plan, while reasonably successful when employed, was significantly underutilized, as it was apparent that most of the applicants for Citizens' policies had not submitted to the Plan requests for insurance. As shown by Table 3, we found that the 68,646 requests for coverage received by the Plan during the calendar years 2008 through 2011, represented less than 6 percent of

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the new personal residential policies written by Citizens during that period. While Citizens participated in various Market Assistance Plan promotional activities (for example, public service announcements, print and television outlets, etc.), additional opportunities exist to promote and increase the production of voluntary insurer placements. Specifically, promotional programs were generally not targeted at real estate professionals, mortgage companies and brokers, and others involved in the sale of real estate. Such promotional activities may help to increase the number of plan requests and voluntary insurer placements.

Absent greater promotion and use of the Plan, the opportunity to place additional risks in the voluntary market may be lost.

**Recommendation: We recommend efforts to promote the Plan continue and that consideration be given to targeting promotional programs at those involved in the sale of real estate.**

Citizens agrees that efforts to promote the Plan must continue and in furtherance of this goal the following initiatives are planned for 2012:

- Attended multiple agent conferences during the first half of 2012 to promote the program;
- Added FMAP to our mandatory Agent Certification Program to ensure all newly appointed agents are made aware of the program; and
- Actively working to finalize and distribute a FMAP brochure to the realtor community via various real estate associations.

**Finding No. 4: Barriers to Take-Outs**

As shown in Table 4, take-outs peaked in calendar year 2008 and significantly decreased during the next three years. As part of our procedures to identify some of the reasons for these significant decreases, we contacted various insurers who had previously participated in the take-out programs.

Of the 17 different insurers who had taken policies out since March 1, 2008, 13 insurers were still in business and 4 (representing approximately 27 percent of take-out activity during that period) had been liquidated. We interviewed representatives of 9 insurers representing approximately 67 percent of the take-out activity during the period March 1, 2008, through December 31, 2011. The following are some of the barriers referenced by these insurers:

- Citizens' premium rates were viewed as being relatively low and voluntary insurers found it difficult to match those rates (4 of 9 insurers).
- Pursuant to Section 627.3517, Florida Statutes, the agents and the policyholders could opt-out of a take-out and that ability made it difficult for a voluntary insurer to take-out and retain policies (5 of 9 insurers).<sup>6</sup>
- The cost of reinsurance made the take-out of policies unprofitable, particularly if policyholders subsequently opted-out. (2 of 9 insurers).

As part of our review of the effectiveness of Citizens' take-out programs, we also noted that Citizens had surveyed insurance companies in an effort to identify barriers to depopulation.<sup>7</sup> Similar to the results shown above for our interviews, Citizens' summary of its survey identified as barriers Citizens' premium rates, the consumer choice law (Section 627.3517, Florida Statutes), and the costs and availability of

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reinsurance. In addition, Citizens' survey found that the following also adversely impacted the effectiveness of the depopulation programs:

- The amount of premium retained by Citizens to cover its expenses (ceded commissions) relative to the policies taken out was viewed by some insurers as a barrier to depopulation. To address this issue, Citizens eliminated the ceding of commissions, effective for any take-outs during the fourth quarter of calendar year 2011 forward.
- Citizens' underwriting guidelines sometimes differed from those of other insurance companies, thereby creating difficulties in evaluating policies for take-out.
- Some insurers noted that Citizens' policy systems sometimes contained incorrect policy data, which could lead insurance companies to take on additional risk that was not anticipated, as well as calculate premium amounts that were inadequate for the actual risk covered.

**Recommendation: Based on the above information, actions that could enhance the effectiveness of depopulation efforts include:**

- As Citizens' premium rates increase, as scheduled by Section 627.351(6)(n)6., Florida Statutes, the premium rates offered by voluntary insurers may become a more attractive alternative for Citizens' policyholders, as long as voluntary insurer rates are not similarly increased.
- Changes to Section 627.3517, Florida Statutes, to further limit the ability of a Citizens' policyholder or policyholder's agent to opt-out of a take-out offer, may also contribute to an increase the effectiveness of the take-out program. For example, that statute could be amended to require that, if an agent is unwilling or unable to accept an appointment from a take-out insurer, then the policyholder must engage an agent of the take-out insurer.
- Citizens' personnel indicated that a collaborative effort was planned for the conduct of a policy data validation review. The completion of such a review and any indicated corrective measures may contribute to an increase in insurer interest in the take-out of Citizens policies.

Citizens' personnel is actively engaged in broadening the range of policy data made available to voluntary insurers, with certificates of authority, who are interested in taking out policies. In addition, actions have been taken to ensure the data received is accurate and if it changes during the course of the takeout process update data is provided.

**Finding No. 5: Take-Out Bonus Overpayment**

Effective June 30, 2006, Citizens entered into a PLA Three Year Bonus Assumption Agreement (Assumption Agreement) with a take-out insurance company (TOIC). This agreement covered the individual three-year bonus take-outs initiated between Citizens and TOIC for the period June 30, 2006, through December 31, 2008. During that timeframe, Citizens and TOIC entered into seven different take-outs removing 37,947 policies from Citizens, resulting in a gross bonus of \$9,180,296.<sup>8</sup> Citizens paid the bonus through an escrow account with monthly amortization of the bonus amount over a three-year time period. At the end of the three-year time period, an independent accounting firm was to be engaged to determine for a sample of active and cancelled take-out policies, whether the TOIC properly classified the policies as eligible for the bonus.<sup>9</sup>

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Following the receipt of the independent accounting firm's report, Citizens determined that the bonus amount to be paid to the TOIC totaled \$7,271,864. As part of our audit, we reviewed the calculation and payment of the bonus amount to the TOIC. Our review of the bonus calculation disclosed that in calculating the bonus amount, Citizens did not include a proration adjustment. Exhibit B to the Assumption Agreement indicated that for any eligible policy which cancels for a valid reason, the bonus or additional bonus was to be paid on a pro-rata basis corresponding with the time the policy was in force with the assuming insurer.

In response to our audit inquiry, Citizens responded that a proration adjustment should have been made for the policies cancelled for valid reasons prior to the end of the three-year time period and determined that the proration amount that should have been recovered from the TOIC totaled \$2,584,438. Subsequent to our inquiry, Citizens recovered the adjustment amount.

**Recommendation: We recommend for any future bonus assumptions that Citizens ensure the consideration of all factors that may affect the calculation of the bonus.**

Assumption agreements that contain a provision for payment of a bonus generally do not require that the bonus be prorated; the bonus provision of the assumption agreement identified in Finding No. 5 was isolated and specific only to that assumption agreement. At the time when this assumption agreement was executed, the intent was for all future assumption agreements to include a provision for proration of bonus amounts. Shortly after this assumption agreement was executed, the bonus program was eliminated and therefore this assumption agreement was the first, and only, assumption agreement that included a prorated bonus calculation. Procedures to verify the final bonus payment performed by Citizens staff and the independent accounting firm are thorough and subject to various levels of review, and historically have had no errors – however, the unique nature of the bonus provision in this agreement was not initially identified during the verification process and therefore resulted in an overpayment.

Should future assumption agreements provide for a bonus payment, Citizens will ensure that all elements of the underlying agreement are properly reflected in the resulting bonus payment.

**Finding No. 6: Customer 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 on May 20, 2011, to 1,000 policyholders who had policies in effect at some point during the period January 2010 through April 2011, including 500 who had claims that were closed during that same period. Questions were included in the survey to address customer satisfaction with services relating to policy issuance, policy renewal, and claims handling. We also included questions to measure policyholder satisfaction with the services provided by Citizens' agents, Citizens' customer service, and overall satisfaction with their insurance policies. We received 243 policyholder responses to our survey. Our evaluation of the results for all surveyed policyholders, as shown by Table 5, indicated that most policyholders were satisfied with the services received from Citizens and Citizens' agents. In comparison to the measurements of customer service satisfaction reported in audit report No. 2009-102, the percentage of satisfied to very satisfied policyholders

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increased for the various customer service categories, except for call center operations, for which we noted a relatively small decline in policyholder satisfaction.

Complaints

As part of our audit of Citizens' customer service function, we analyzed Department of Financial Services (DFS), Division of Consumer Services, data available for the period January 1, 2010, through December 31, 2011, to identify any indications of significant customer service issues. As shown in Table 6, we found that during this period, Citizens ranked fourth among the top 11 Florida residential, commercial, and other property and casualty insurers in terms of the number of complaints as a percentage of policies in force as of September 30, 2011. The number of complaints and the frequency of the complaints significantly decreased for Citizens as compared to the Complaints as a Percentage of Policies in Force at September 30, 2007, table reported in Report No. 2009-102.

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 its agents have the necessary resources to cost-effectively serve policyholders including adequate training, the availability of policyholder information electronically, and consistent support from Citizens' underwriting, claims, and other staff. To measure agent satisfaction with the resources made available by Citizens and to identify potential areas where Citizens could enhance its operations with respect to its appointed agents, we mailed surveys on June 13, 2011, to 700 appointed agents.<sup>10</sup> Questions were included in the survey to gauge agent satisfaction with, among other things, Citizens' training program, its primary electronic policy administration systems (ePAS, eDOCS, and the Agency Link [Commercial Policyholder Information]), service provided by Citizens' staff, and overall satisfaction with Citizens' agent support. Our evaluation of the survey results, as shown by Table 7, indicated that most agents were satisfied with Citizens' operations. Our prior audit disclosed similar levels of agent satisfaction.

**Recommendation: We recommend that Citizens continue its efforts to provide customer service which is no less than the quality generally provided in the voluntary market.**

*Citizens will continue to strive to do so.*

**Finding No. 7: Claim Adjustment and Payment**

Generally, Citizens processed the sampled claims in accordance with its written guidelines and industry best practices. However, as similarly noted in audit report Nos. 2006-096 and 2009-102, Citizens did not perform an insurance-to-value analysis at the time of loss adjustment, a step that must be taken in order to enforce the 80 percent co-insurance clause included in various policies issued by Citizens. Such an analysis helps ensure the property is appropriately insured at an amount commensurate with the property's replacement cost. Should the analysis show that a property's value, as shown by the policy, is less than 80 percent of the property's estimated replacement cost, Citizens, then pursuant to policy loss settlement provisions, may become responsible for a smaller portion of the claim.

Our audit tests disclosed that for 94 of 108 applicable claims, no insurance-to-value calculation was performed. In response to our inquiries, Citizens' management indicated that Citizens was continuing to move toward a process that would include completion of an insurance-to-value calculation and the

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application of the co-insurance clause and that it has started performing insurance-to-value calculations on some claims.

The performance of insurance-to-value analyses will allow Citizens to enforce policy co-insurance clauses and pay claims on a pro-rata basis when the amount insured is less than 80 percent of replacement cost.

**Recommendation: We recommend Citizens continue implementation of insurance-to-value calculations and application of co-insurance penalties, where applicable.**

Citizens agrees with this recommendation and will continue to move forward, in accordance with Florida Statutes and applicable policy language.

**Finding No. 8: HRA Liquidity Financing**

In order to have sufficient cash on hand to pay HRA account catastrophic losses, Citizens has provided for liquidity through the issuance of pre-event bonds (bonds issued in anticipation of storm events). Because the cash must be available to pay claims when needed, a primary goal must be the maintenance of the safety and liquidity of the proceeds through conservative investment. There is also, however, a need to minimize the cost of carrying the debt (cost-of-carry). The cost-of-carry is defined as the difference between the interest expense accruing on the debt and the investment earnings accruing on the proceeds while they are available for investment. The cost-of-carry can be minimized over the life of the debt by initially structuring the debt issue such that the interest rate on the debt is matched as closely as possible to expected rates of return on conservatively invested proceeds. Our review of the effectiveness of the steps taken by Citizens to maintain the safety and liquidity of the invested proceeds and to minimize the cost-of-carry disclosed that Citizens issued pre-event debt and paid issuance costs at rates not considered excessive and had earnings that appeared reasonable based upon the safety and liquidity criteria in its investment policy. During the period July 2008 through December 2011, the cost of providing the HRA with additional liquidity of \$3.8 billion (amount outstanding at December 31, 2011) to pay potential claims in the event of a catastrophic event was approximately \$353 million as shown in Table 8. 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 Section 627.351(6)(n), Florida Statutes, the premiums collected become more consistent with those that would be calculated using actuarially-determined rates. For example, as shown in Table 2, the use of actuarially-determined rates may have produced additional HRA premiums of up to \$1.9 billion for the period January 1, 2008, through December 31, 2011. 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 continue its efforts to reduce the cost-of-carry on any pre-event financing while maintaining the safety and liquidity of the financing proceeds through conservative investment. We also recommend that, to the fullest extent authorized, Citizens collect premiums based upon actuarially-determined rates.**

Each year, Citizens files the indicated actuarially sound rates with the OIR. Due to the rate freeze in place from 1/1/2007 through 1/1/2010, and the subsequent 10% policy level annual rate increase cap, Citizens' rate level is currently less than fully adequate. To the fullest extent authorized, Citizens does charge the premium based upon actuarially-determined rates. Each year the rates are based on the

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fully indicated premium but then these rates are capped to ensure there is no rate increase greater than 10% for each policyholder. Citizens will continue to adjust rates towards actuarial soundness to the extent allowed by law.

**Finding No. 9: Emergency and Sole Source Procurement Practices**

Citizens' procurement is governed by Section 627.351(6)(e), Florida Statutes, which states that purchases which equal or exceed \$2,500, but are less than \$25,000, shall be made by receipt of written quotes, written record of telephone quotes, or informal bids, whenever practical. The procurement of goods or services valued at over \$25,000, shall be subject to competitive solicitation, except in situations where the goods or services are provided from a sole source or are deemed an emergency purchase, the services are exempted from competitive solicitation requirements under Section 287.057(3)(f), Florida Statutes, or the procurement of services involves the sale of bonds pursuant to Section 627.3513, Florida Statutes. Section 627.351(6)(e), Florida Statutes, also requires that the justification for sole source or emergency procurement be documented. Effective April 2008, Citizens' procurement policy allowed for emergency and sole source purchases, as shown below:

- Under the April 2008 procurement policy, an emergency purchase was permitted to obtain goods and services in the event of a catastrophe situation, a disruption or interruption of essential services, or when the time required to issue a competitive solicitation would be detrimental to the interests of Citizens. The emergency purchase required the approval of the Senior Vice-President or higher. Effective April 2010, the emergency purchase policy was amended to allow emergency procurement when the time required for competitive procurement would be detrimental to the material interests of Citizens and its policyholders and to require approval of the President and, when practical, the Chair of the Board of Governors.
- Under the April 2008 procurement policy, a sole source purchase could be authorized when goods or services were available from only one source or the provider of the services was uniquely qualified as determined by an analysis of the marketplace. A sole source procurement required the approval of the Director of Purchasing and General Services (Director). Effective April 2010, the policy was revised to permit a sole source purchase only when the required goods or services were available from only one supplier; or the purchase will continue or expand an imbedded technology system or service already in use by Citizens, provided the continuation or expansion can be justified by the applicable business unit.

Subsequently, in August 2010, the Chief Financial Officer (CFO) and the President of the Florida Senate requested Citizens implement additional contract reforms to ensure accountable and competitive contracting. Effective January 2011, Citizens' procurement policy was amended with respect to emergency and sole source purchases to require additional scrutiny of such proposed purchases and a higher level of approval, as follows:

- Emergency purchases are allowed when the President, in consultation with the Chair or Vice Chair of the Board, determines in writing that an immediate danger to the public health, safety, or welfare or other immediate and substantial loss to Citizens or its policyholders requires emergency action. Under such circumstances, Citizens, whenever practicable, is to obtain pricing information from at least two prospective vendors, which will be retained in the contract file. Citizens is also to provide a report of any emergency procurement to the Board of Governors at its next scheduled meeting. An emergency purchase of goods or services shall be limited to the

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scope and time required to meet interim needs and complete a competitive solicitation process and transition time, if necessary.

- Sole source purchases are allowed when an analysis of the marketplace for the good or service is conducted by Citizens, and Citizens determines in writing that the required good or service is available from only one supplier, or is necessary or unique, for example, where the deliverable is copyrighted, patented or proprietary, or where there is an absence of competition or providers in the marketplace. When Citizens reasonably determines that goods or services qualify as a sole source purchase, Citizens shall post on its Web site a description of the goods or services sought for a period of at least seven (7) business days. The description must include a request that prospective vendors provide information regarding their ability to supply the goods or services described. If it is determined in writing by Citizens, after reviewing any information received from prospective vendors, that the goods or services qualify as a sole source purchase, Citizens will notify the vendor(s) and proceed with the purchase. A sole source procurement will be discontinued and a competitive solicitation instituted when written information is timely received which demonstrates that additional prospective vendors can supply the goods or services sought.

The changes in procurement policy have contributed to a decline in the number of sole source and emergency contracts procured. In a September 3, 2010, response to the Senate President, Citizens indicated that from January 2008 through July 2010, Citizens entered into 40 sole source contracts and 47 emergency contracts estimated to cost more than \$25,000. Subsequent to July 2010, and through November 17, 2011, the number of contracts that were considered sole source procurements decreased to 19 and were primarily related to software licenses or maintenance agreements for existing software. No contracts were in effect which had been procured as emergency procurements.

As part of our audit, we tested 10 contracts, with estimated costs totaling \$9,576,868 that Citizens had awarded during the period January 2010 through June 2011. We judgmentally selected the contracts and included in our test, contracts that were competitively awarded and those which had been awarded as emergency or sole source procurements. Our audit indicated that for the contracts tested, the procurements were made in accordance with the procedures in place at the time of procurement; the receipt of the required goods and services was documented; and the contractors were appropriately monitored.

**Recommendation: We recommend that Citizens continue to emphasize the use of competitive procurement methods.**

Citizens agrees with this recommendation and will continue to move forward in accordance with Florida Statutes.

**Finding No. 10: Termination of User Access**

Effective security controls include provisions to timely disable employee access privileges to information and data when employment termination occurs. Prompt action is necessary to ensure that a former employee's access privileges are not misused by the former employee or others.

Citizens had implemented procedures to remove the access privileges of employees who terminated employment. Under the procedures, access for voluntarily departing employees was to be revoked upon

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termination, unless the Citizens Information Security Department (CISD) recommended otherwise. Such procedures required that user management submit a User Access Management (UAM) form to CISD identifying the specific applications for which access privileges were to be disabled. Upon receipt of notification, CISD was to disable access privileges to those applications. Additionally, CISD had implemented a process, Computer Access Management (CAM), to identify applications that had not been accessed by a user during the preceding 30 days. For such applications, a request was to be sent to user management indicating that the user had not logged on for 30 days and inquiring whether the access privileges should be disabled. If no response was received, CISD's procedure was to terminate access after 60 days of inactivity.

Our tests disclosed that, in some instances, the established security procedures had not effectively ensured timely termination of user access. Tests of the timeliness of termination of the access privileges for 209 employees who terminated during the period January 1, 2010, through June 14, 2011, disclosed:

- For 11 employees, access privileges to various applications (CAIS, CTS, ePAS, and Wind) were not timely terminated due to user management not marking on the UAM form the space provided for the application. Access privileges were subsequently removed on dates ranging from 6 days to 169 days after termination. For 1 of these 11 employees, user management had marked ePAS and Wind access privileges for termination, but CISD did not terminate the access. For this employee, access privileges were subsequently disabled 133 days after termination.
- For 2 employees, access privileges to AAS were not timely terminated because the UAM form did not make provision for the AAS application. Access privileges for the 2 employees were subsequently disabled 111 and 115 days, respectively, after termination.
- For 1 employee, user management did not submit a UAM form requesting disabling of CAIS access privileges. Access privileges were disabled 158 days subsequent to termination.

The CAM process, due to its manual nature, did not result in the disabling of the user access privileges as the control was intended. CISD stated that until May 2011, CAM reporting for CAIS, CTS and Wind had been ad hoc. As of May 2011, consistent reporting became available for all systems.

In response to our inquiries, CISD has indicated that security awareness training will include reinforcement that user managers are responsible for the control of access to their applicable application systems and accountable for ensuring the security of data. CISD also indicated that the UAM form will be enhanced to include all major applications.

**Recommendation: We recommend that Citizens ensure that access privileges are timely disabled.**

Citizens agrees with this recommendation. The Information Security Computer Account Management (CAM) Program Improvement Plan has been applied to critical Citizens applications/systems. Citizens' applications/systems identified as requiring CAM program management, but not yet part of the CAM Program, will be incorporated. The Citizens Security Awareness program has been revised to reinforce the principle that data owners are responsible for ensuring the security of business data.

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CAM Program reporting improvements have been implemented and a program status dashboard will be maintained on the Information Security Portal. Reporting enhancements include:

- Application/System Active User Account Reporting and Remediation,
- Regular Validation of Application/System User Population and Roles by Data Owner, and
- Data Owner Certification of Application/System Security Matrix.

**Finding No. 11: Other Security Controls**

Security controls are intended to ensure the confidentiality, integrity, and availability of data and protect information technology (IT) resources. Our audit disclosed certain security control deficiencies related to Citizens' IT systems, in addition to the user access control issues disclosed in Finding No. 10. We are not disclosing specific details of these other security control issues in this report to avoid the possibility of compromising Citizens' data and IT resources. However, we have notified appropriate management of the specific issues.

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

Citizens agrees with this recommendation and is in the process of implementation of a specific solution for the enforcement of required controls for the systems noted in the recommendation.

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