



# **THE STATE OF FLORIDA**

## **OFFICE OF INSURANCE REGULATION MARKET INVESTIGATIONS**

### **TARGET MARKET CONDUCT FINAL EXAMINATION REPORT OF THE FLORIDA AUTOMOBILE JOINT UNDERWRITING ASSOCIATION**

**June 12, 2014**

**FLORIDA COMPANY CODE: 99008**

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## **EXECUTIVE SUMMARY**

An operational review of current systems and controls was performed and included the evaluation of processes for corporate records, general operations, accounting, information systems, complaint handling, underwriting and rating, general claims, reserves, anti-fraud plan, legislative changes, procurements, and pending litigation.

It is noted that there was a significant increase in both policy count and in claims during the year ending September 30, 2012. The Florida Automobile Joint Underwriting Association (FAJUA or Association) indicates that they are experiencing a significant increase in adverse loss frequency and adverse ratio development. Based upon the FAJUA's review, many of the more recent losses may be attributable to fraudulent insurance claims. These influences are placing significant financial strain on the FAJUA and its supporting members. Assessments greater than historically experienced will be necessary to cover the increase in losses.

The following table reports general findings related to violations; specific details are found within the report.

<u><b>TABLE OF VIOLATIONS</b></u>			
<b>Statute/Rule</b>	<b>Description</b>	<b>Files Reviewed</b>	<b>Number of Violations</b>
627.318	Failure to maintain a current agreement with the service provider.	n/a	1
626.9541(1)(j)	Failure to maintain a standardized complaint log.	n/a	1

## **PURPOSE AND SCOPE OF EXAMINATION**

The Florida Office of Insurance Regulation (Office), Market Investigations, conducted a target market conduct examination of The Florida Automobile Joint Underwriting Association (FAJUA or Association) pursuant to Section 624.3161, Florida Statutes. The scope period of the examination was January 1, 2009 through September 30, 2012. The onsite examination began December 17, 2012 and ended January 15, 2013. Following the conclusion of the on-site examination, additional examination and analysis of the Association were performed and ended on June 12, 2014.

The purpose of this examination was to determine FAJUA's compliance with Florida Statutes, the Florida Administrative Code, its filed plan of operation, and its internal operational procedures. The operational review of current systems and controls included the evaluation of processes for maintaining corporate records, general operations, accounting, complaints review, underwriting and rating, general claims review and responsiveness to legislative changes.

FAJUA utilizes three service providers to perform underwriting, policy administration, claims, accounting and statistical functions. Information pertaining to the internal controls and service providers was provided by the Certified Public Accounting firm Thomas Howell Ferguson, P.A. (THF), who perform detailed testing of the association's internal controls. This examination incorporated testing of internal controls performed by THF.

FAJUA records were examined at the Association's home office located at 1425 Piedmont Drive East, Suite 201A, Tallahassee, Florida. Documentation utilized in this report was provided by the Association, the independent auditors, and other external sources.

This Report is based upon information obtained during the examination, additional research conducted by the Office, and additional information provided by the Association. Each finding was reviewed and provided to the FAJUA. Procedures and conduct of the examination were in accordance with the *Market Conduct Examiner's Handbook*, and the *Financial Condition Examiners Handbook* produced by the National Association of Insurance Commissioners.

## **OPERATIONS REVIEW**

### **CORPORATE RECORDS**

The FAJUA was established on February 9, 1973, pursuant to Sections 627.311 and 627.351, Florida Statutes, by order of the Insurance Commissioner in Case No. 73-RR-03H, for the purpose of establishing and carrying out a program of providing automobile insurance to qualified applicants unable to procure such insurance through the voluntary market. Legislation authorizing and governing the FAJUA is codified in Sections 627.311 and 627.351, Florida Statutes. The Association accounts for its activities using a fiscal year ending on September 30<sup>th</sup>; it is exempt from federal income taxes in accordance with Section 501(c)(6) of the United States Internal Revenue Code, and is tax exempt in Florida by statute.

The FAJUA is a Florida unincorporated association whose members consist of each property insurer possessing a certificate of authority to write automobile liability insurance and automobile physical damage insurance in Florida. As participating members of the FAJUA, all member companies receive quarterly and annual reports indicating their participating share of the FAJUA's experience by policy year. Each member's share of the annual operating results of the Association is calculated based on a formula memorialized in the FAJUA Accounting and Statistical Requirements Manual. Each member company is required to report its share of the annual operating results of the FAJUA in its statutory annual statement filed annually with the Office.

The Association operates under the supervision of an eleven member Board of Governors (Board) pursuant to a filed and approved Plan of Operation. Five of the Board members are appointed by the Florida Chief Financial Officer, of which two are from the insurance industry; six are appointed by member insurers and include two chosen from the insurance agents associations. Board members serve for two-year terms or until their successor is chosen. Each member of the Board has one vote, and six members constitute a quorum.

The examination testing procedures included reviewing the FAJUA:

- plan of operation;
- board and committee meeting minutes;
- work papers and reports of external audits performed during the scope period;
- organizational chart; and,
- prior examination findings for completed remediation.

A review of the FAJUA's present processes determined that the Association has adopted all of the recommendations made in the prior exam with the exception of two concerns.

## GENERAL OPERATIONS

The FAJUA possesses the authority to assess its members for anticipated cash needs. A review of the 2008 through 2011 and subsequently 2012 and 2013, cash flow reports indicates that the Association made the following assessments and membership fees and distributions:

<u>Year Ending (September 30)</u>	<u>Assessments and Membership Fees</u>	<u>Assessment Disbursements</u>
2008	\$13,358,562	\$2,920,691
2009	1,693,190	3,627,050
2010	3,967,910	3,321,772
2011	2,498,778	1,859,773
2012	2,185,095	(2,206,195)
2013	12,805,320	9,934,387

Assessments and disbursements are used as the basis for projecting assessments required the following year. The FAJUA may distribute any excess amounts to member companies based on their pro rata share of written premiums for any closed accident year.

FAJUA does not assume or cede any reinsurance risk. The Association provides for its cash needs through assessments, has no letters of credit, lines of credit or bond issues outstanding.

The Association is managed by a General Manager who reports to the Board. The FAJUA convenes an annual meeting of members consisting of all the insurers authorized to write automobile liability or automobile physical damage insurance in Florida.

The FAJUA maintains a staff of four employees as of September 30, 2011, consisting of a General Manager, Underwriting Manager, Agents Record Clerk, and an Administrative Assistant. A reliance on third party service providers permits the Association to operate with limited staff.

The duties of the General Manager include but are not limited to investing funds, establishing, and monitoring the annual budget, evaluating, and recommending outside service providers, making of rate filings, communication with the OIR and oversight of day-to-day operations.

Other than appointment of agents, operational activities of the FAJUA are performed by three service providers, as follows:

- AIPSO – providing services to the FAJUA since 1984, performs most of the day-to-day financial accounting including:
  - payroll, accounts payable, bank account reconciliations;
  - maintenance of general ledgers;

- preparation of financial statements and statistical reports;
  - premium tax accounting; and,
  - other data services and audit services, as necessary.
- York Risk Services Group, Inc., (formerly York Claims Service, Inc.) - providing claims administration services to the Association since 2006, including:
    - supervision of the loss adjustment process;
    - providing comprehensive analysis and policy coverage documentation;
    - determination and implementation of appropriate claims practices in accordance with claims guidelines;
    - adjustment and management of assigned claims ensuring that policyholders and claimants receive high quality service;
    - establishing, monitoring and timely revision of case reserves;
    - claim settlement within policy coverage terms and conditions;
    - assistance in preparation of claims brought for suit, trial, or subrogation;
    - coordination with defense counsel; and,
    - preparation and submission of status and administrative reports in accordance with the FAJUA claims guidelines.
  - Dovetail Insurance Corporation - providing policy administration services to the Association since 2008, including:
    - underwriting;
    - issuing policies;
    - collecting premiums; and,
    - accounting, statistical, and data processing.

### **Findings**

1. In 1 instance the Association failed to maintain a current agreement with the service provider AIPSO. The AIPSO Agreement to Provide Services was effective November 1, 2004 for a four-year term, and was renewed for an additional four-year term. Pursuant to the terms of the agreement, the renewal expired on October 31, 2012. The Office finds this to be a violation of Section 627.318, Florida Statutes.

**Corrective Action:** The Company should maintain a current, executed agreement with AIPSO.

**Association's Response:** A current agreement has been drafted. The FAJUA will provide the Office with a copy of the agreement as soon as it is executed.

**Subsequent Event:** On June 12, 2014, the Association provided the Office a copy of the renewed AIPSO contract. The contract expires November 1, 2017, and contains automatic renewal provisions.

## **ACCOUNTING**

A review of FAJUA's accounting processes and procedures was completed for the period under examination. Testing procedures included verifying:

- trial balances agreed to the filed Annual Statement at September 30, 2011;
- 2011 Annual Statement agreed to the audited financial statements;
- all filings as required by the Office and the State of Florida Department of Financial Services were completed; and,
- reviewing of the processes and procedures for financial reporting.

As required by the Office, the FAJUA performs annual audits of its financial statements. For the reporting periods ending September 30, 2011 and 2010, audits were performed by THF, who issued unqualified opinions.

A review of the Association's financial reporting processes and procedures and of the audit performed by THF did not identify material weaknesses in controls over the financial reporting processes.

## **COMPLAINTS REVIEW**

FAJUA complaints may originate from diverse sources including Florida Regulatory, Legislative, and Executive offices, and from consumers. A review of the complaint register provided to the Office finds:

- eight entries between May 7, 2010 through August 21, 2012;
- seven of the eight entries resolved and closed; and,
- one entry open as "Awaiting Company Response."

The complaints summarize as follows:

- one agent issue;
- one coverage issue;
- two premium issues; and,
- four claims issues.

Review of the Department of Financial Services Consumer Services complaint reports does not indicate any trending. During the prior examination, it was recommended that the FAJUA ensure that all complaint logs maintained by service providers are standardized and include a description of the complaint, a description of the response to the complaint, and the date of the response to the complaint. During the current examination, the Examiners requested complaint registers from the Association and the service providers. The Association indicated that neither they nor the service providers were maintaining a complaints register or complaints listing.

## **Findings**

1. In 1 instance the Association and its service provider failed to maintain a standardized complaint log. This is a violation of Section 626.9541(1)(j), Florida Statutes. Neither the Association nor the service providers maintain a complaint register or complaint lists.

**Corrective Action:** The Association should ensure that complaint logs maintained by service providers are standardized and include a description of the complaint, a description of the response to the complaint, and the date of the response to the complaint. This recommendation was included in the prior examination.

**Association's Response:** A formal request to maintain standardized complaint logs will be made to the service providers. FAJUA staff will follow-up on a regular basis.

**Subsequent Event:** In May 2014, the Association provided verification of compliance with Complaint Log Procedures. Verification included adoption of a standard complaint log template and documentation illustrating that service providers are maintaining the standard complaint log adopted by the Association. Complaint logs are reviewed quarterly.

## **UNDERWRITING AND RATING REVIEW**

Dovetail Insurance Corporation provides policy administration services to the Association pursuant to the Underwriting Manual published by the FAJUA. Policy administration services include underwriting, policy issuance, premium collection, accounting, statistical and data processing. THF performs a substantive review of a random sample of records during the annual audits of the FAJUA.

Examination testing procedures included reviewing:

- FAJUA filed plan of operation;
- underwriting rules, practices and rates utilized during the scope period;
- randomly selected files to determine eligibility, compliance with rule and rate filings, Florida Statutes, and the FAJUA Plan of Operation; and,
- randomly selected files to verify compliance with the prior examination and audit underwriting recommendations.

After a review of controls and of the results of other audits recently performed, additional testing was not indicated. THF performed sample reviews and did not report compliance concerns with the Association's operation plan or violation of Florida Statutes.

**Subsequent Event:** Subsequent to the completion of the examination, the Office obtained THF audits of the FAJUA completed February 2014 that identified an

approved rate change effective in March 2013 had not been implemented. Additionally, in April 2014, the service provider, AIPSO, completed a compliance audit review.

The Association has implemented corrective actions recommended in both the THF and the AIPSO audits including increased reporting by, and oversight of the policy services administrator and performing additional compliance audits. The Board has contracted with Blue Cod Technologies to administer policy administrative services beginning August 1, 2014.

## **GENERAL CLAIMS REVIEW**

### **Claims Summary (as of September 30, 2013):**

Description	2013	2012	2011	2010	2009
Losses Paid	\$11,963,048	\$4,424,222	\$ 836,051	\$642,089	\$2,622,007
Net Losses Unpaid					
Current Year	\$ 5,181,000	\$4,093,000	\$2,395,000	\$2,346,681	\$3,479,647
Net Losses Unpaid					
Prior Year	\$ 4,093,000	\$2,395,000	\$2,346,681	\$3,479,647	\$5,921,891
Losses Incurred					
Current Year	\$13,055,571	\$6,122,222	\$ 884,370	(\$490,877)	\$ 179,763

A significant increase in claims developed during the fiscal year ending September 30, 2012. The FAJUA reported experiencing significant adverse loss frequency and adverse ratio development. This trending continued throughout 2012 placing significant financial strain on the FAJUA and its supporting members. Increased assessments have become necessary to cover losses. Following the September 2012 Board meeting, the Association increased the frequency of assessments from annually to quarterly. The Office was informed of an assessment of \$5,500,000 levied in November 2012, with additional assessments in January 2013 of \$4,300,000, \$750,000 in April 2013, and \$3,600,000 in January 2014. The Association explained that assessments, “approved by the Board of Governors, are based upon cash flow projections provided quarterly by the central processor, AIPSO, using a twenty-month calculation with a \$1,000,000 threshold.”

Based upon internal FAJUA analysis, the trending in increasing losses is, in part, likely attributable to incidents of fraudulent claims. The Association has created, based upon the Board’s guidance, an SIU unit dedicated to investigating, reporting, and deterring fraud on a going-forward basis. At the December 2012 meeting, the Board formally approved a contract with G4S, an international insurance and corporation fraud prevention, detection and investigation firm. Referrals to G4S are estimated to raise claims administration costs \$3,000 to \$3,500 per suspect claim. Beginning in April and May 2013, the FAJUA received its first reports from G4S. Analysis initially focused on identifying suspect agent-sourced fraud and identifying organized insurance fraud operations.

G4S agency reviews targeted:

- high-claim volume agencies;
- high-loss severity agencies;
- unusual claim activity;
- application and submission scrutiny; and,
- on-site agency visits.

G4S claims analysis also focused on providers for monitoring and scrutiny.

Speedier claims evaluation and improving communication between the claims administrator York Risk Services Group, Inc. (York), General Counsel, Defense Counsel, SIU firm G4S, and the Board are quickening identification of suspected fraudulent claims. As of the April 2014 Board meeting, claims management is credited with identifying suspect claims and reducing losses.

York provides all claims administration services to the FAJUA in accordance with FAJUA Claims Guidelines. During the annual audits of the Association conducted by the external auditors, THF, a substantive review of a random sample of records was performed. Examination testing procedures included reviewing:

- claim handling procedures;
- population of claims reported during the scope period;
- random files from the overall population of claims to be reviewed;
- policy records for each claim selected confirming coverage was applicable; and,
- complete claim files for each selected claim to confirm claims processes meet all statutory requirements and comply with internal procedures.

In addition to testing performed by THF, KPMG, LLP, prepared a Service Organization Control (SOC 1) Report as of September 30, 2011. KPMG opined that the controls were suitably designed to provide reasonable assurance that the control objectives would be achieved if the controls operated effectively throughout the period, and that the controls operated effectively throughout the period. A bridge letter was also provided by KPMG for the period of October 1, 2011 through September 30, 2012.

Responding to Office inquiries following the on-site examination, the Association reiterated the Board actively participates in managing the Association affairs. The Board authorizes funding of a special prosecutor position in the Hillsborough County State Attorney's office in Central Florida to prosecute suspected fraud. The special prosecutor actions are credited with contributing towards a reduction in fraudulent activity in the Hillsborough County region including identifying activity occurring at unlicensed health clinics. As of June 2014, claims costs continue a downward trend in the region.

The Association continues to lobby for and pursue special funding for a dedicated prosecutor position in the Miami-Dade/Broward County State Attorney's Office.

## **ADOPTION OF LEGISLATIVE CHANGES**

For purposes of its tax-exempt status, the FAJUA is considered a political subdivision and an integral part of the state of Florida. As such, the FAJUA's operations are affected by legislative actions.

As part of the examination, a review was conducted of the processes and controls the Association has in place to monitor and communicate the legislative changes affecting the FAJUA operations. The Association contracts with Floridian Partners, LLC, to monitor and report legislative changes impacting the FAJUA.

Since 2004, several legislative provisions have been adopted into Florida law affecting the operations of automobile insurers. Three changes affecting the FAJUA occurred in:

- 2004 – SB 2038 providing the FAJUA an additional 30 days to investigate claims that appear to be fraudulent. This provision of the bill was set to expire in October 2007, unless re-enacted; also,
- 2004 – SB 2038 included a provision authorizing the FAJUA to require proof of replacement coverage before refunding unearned premiums; and,
- 2007 – non-reauthorization of the 30 day claims investigation extension provision.

FAJUA demonstrated adequate processes and controls to monitor and communicate the legislative changes to the Board and Management.

## **PENDING LITIGATION**

FAJUA is a named defendant in various legal actions arising in the normal course of business from claims made under insurance policies and contracts. These actions are considered by the FAJUA in estimating the loss and LAE reserves. The FAJUA believes that resolution of these actions will not have a material adverse effect on the Association's financial position or results of operations.

## **FINAL EXAMINATION REPORT SUBMISSION**

The Office hereby issues this Final Report based upon information from the examiner's draft report, additional research conducted by the Office, and information provided by the Association.