

Office of the Internal Auditor



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AUDIT REPORT

Claims Resolution

June 2, 2016

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Executive Summary

Background

Citizens' goal is to provide high quality customer service and accurate damage estimates for our policyholders in their time of need. The claims process begins when the First Notice of Loss (FNOL) is reported. An initial review and first policyholder contact is made by a Claims adjuster, who conducts a thorough inquiry and examination of the claims circumstances to determine the cause and origin of the loss. Industry leading estimating tools are used in conjunction with policy coverage considerations to determine a full, fair, and appropriate amount of payment to compensate the policyholder for the loss. In the event the damage is not covered under a policy and payment of the claim is denied, Citizens will provide a written explanation to the policyholder.

Policyholders that disagree with the determination of a claim may utilize alternative dispute resolution processes including mediation and appraisal. Free mediation is available through the Florida Department of Financial Services Division of Consumer Services. A neutral third party meets with the policyholder and Citizens in order to reach an agreement both parties can accept. Mediation is non-binding and neither party is legally obligated to accept the outcome. An appraisal process may be utilized to resolve a disagreement regarding the amount of a covered loss. In this process each party selects an appraiser that will separately set the amount of the loss. In the event that the two appraisers fail to agree, an impartial umpire is selected. A decision agreed to by any two of the parties involved (i.e. policyholder's appraiser, Citizens' appraiser or the umpire) will determine the amount of the loss. On occasion, disagreements in claims handling and resolution may lead policyholders to pursue litigation. Once in litigation, matters are evaluated to determine whether appropriate for resolution without the need for protracted litigation.

Non-weather water loss remains a key driver of claim volumes.

- During 2015, Citizens received 22,740 FNOLs and over half of the FNOLs were due to non-weather water cause of loss.

Citizens was served with 8,074 lawsuits regarding residential property losses from January 2015 through February 2016. Water losses accounted for 82% of the incoming lawsuits with the majority of the water losses due to a plumbing leak or break.

Trends impacting the claims resolution processes include:

- Increase in delay of reporting claims for non-weather water claims where the repairs have already been completed before an evaluation of the loss can occur by a Citizens Adjuster.
- In 2015, an average of 621 new lawsuits are received each month and an analysis of incoming lawsuits determined:
 - Policyholders were represented at the FNOL by a public adjuster, attorney or both 85% of the time.
 - Policyholders did not dispute Citizens' position at the time of adjustment of the claim. (61%)
 - Lawsuits were filed within six months of the FNOL (48%)
- Assignment of benefits (AOB) occur when a policyholder assigns some or all of their rights for a specific claim under the policy to recover insurance proceeds to a contractor. In the event of a lawsuit related to an AOB claim, the contractor is the party filing the lawsuit against Citizens. In

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December 2015 and January 2016, Citizens was served with 249 and 211 new AOB suits respectively which is a 200+% increase over the monthly average of the prior 12 months.

The claims department continues to develop and implement strategies to address these matters. Additional recommendations designed to reduce the impact of non-weather water loss claims were recently proposed and approved by Citizens Board of Governors. Policy contract changes for water losses were recently approved by the Office of Insurance Regulation. The changes effective July 2016 address reasonable emergency measures and loss reporting.

Audit Objectives and Scope

The objective of this audit was to evaluate the adequacy and effectiveness of controls related to claims resolution for front-end claims, mediation, appraisal, and Litigation triage. The scope of the audit included an assessment of controls over the following areas:

- Approval of front end claim denials
- Authorization and approval of settlement agreements
- Receipt of releases
- Compliance with timeliness requirements
- Access to confidential records

The following areas related to claims processes were not included in the scope of this audit because they are or will be addressed in separate engagements: claim check printing and mailing and the Quality Assurance Program. Due to the recent implementation of strategy changes, some control assessments focused only on the first quarter of 2016.

Audit Opinion

Based upon our audit work, the overall effectiveness of the controls evaluated during the audit of Claims Resolution is rated as **Needs Minor Improvement**.

Efforts to strengthen controls and the implementation of improvement initiatives for various claims resolution processes were noted throughout the audit. We found that in general claims resolution transactions are well managed with effective internal controls over the approval of denials, settlement agreements, and receipt of releases.

We noted the following control deficiencies that need to be addressed:

- **Access to medical records is not adequately restricted.** Medical records are obtained for processing liability claims. Claims Center within Citizens Insurance Suite does not currently provide the capability to restrict access to medical record attachments to only the users responsible for processing and managing liability claims. The compromising of restricted medical claim information poses a reputation and regulatory risk to the organization. Implementation of system enhancements to secure the medical record attachment would ensure medical record information is adequately protected and complies with regulatory and corporate policy requirements.
- **Claim Adjuster documentation needs improvement.** During our review, we observed that Claim Adjuster documentation within Claim Center did not consistently adhere to the Citizens

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Best Claims Practices and Estimating Guidelines for file management and content standards. Inconsistent handling of confidential and sensitive information may lead to inaccurate negative public perception, inadvertent disclosures, and negative impacts to the resolution of claim disputes.

Advisory

The following strategic improvement opportunities were identified, discussed with management, and may be considered to increase efficiency:

- **Evaluate the cause and effect relationships, cost benefits, downstream impacts to litigation, and strategic alignment related to the water mitigation vendor estimates for non-weather water claims.** Citizens utilizes water mitigation vendors to provide independent estimates prior to the payment of a non-weather water claims involving repairs by a water mitigation vendor selected by the policyholder. The claim is paid based upon the amount recommended by Citizens' water mitigation vendor, which can be a significantly lower amount than the amount billed by the policyholder's water mitigation vendor. In the sample reviewed, 55% of these claims are reopened as the party pursues the payment of the additional amount through litigation. The process may be increasing expenses due to resource time and litigation costs.
- **Reporting capability for the Appraisal and Non-disputed Matter screens in Claim Center has not been implemented.** Additional information is captured in these screens by the Appraisal and Mediation teams in an effort to provide key metrics and data necessary to enhance the ability to analyze trends and identify improvement opportunities. While inventory reporting information is available in Claim Center to manage the Appraisal and Mediation teams, the data from these specific screens cannot be effectively utilized without the reporting capability.

We would like to thank management and staff for their cooperation and professional courtesy throughout the course of this audit.

Appendix 1

Definitions

Audit Ratings

Satisfactory:

The control environment is considered appropriate and maintaining risks within acceptable parameters. There may be no or very few minor issues, but their number and severity relative to the size and scope of the operation, entity, or process audited indicate minimal concern.

Needs Minor Improvement:

The number and severity of issues relative to the size and scope of the operation, entity, or process being audited indicate some minor areas of weakness in the control environment that need to be addressed. Once the identified weaknesses are addressed, the control environment will be considered satisfactory.

Needs Improvement:

The audit raises questions regarding the appropriateness of the control environment and its ability to maintain risks within acceptable parameters. The control environment will require meaningful enhancement before it can be considered as fully satisfactory. The number and severity of issues relative to the size and scope of the operation, entity, or process being audited indicate some noteworthy areas of weakness.

Unsatisfactory:

The control environment is not considered appropriate, or the management of risks reviewed falls outside acceptable parameters, or both. The number and severity of issues relative to the size and scope of the operation, entity, or process being audited indicate pervasive, systemic, or individually serious weaknesses.

Appendix 2

Issue Classifications

Control Category	High	Medium	Low
<i>Financial Controls (Reliability of financial reporting)</i>	<ul style="list-style-type: none"> Actual or potential financial statement misstatements > \$10 million Control issue that could have a pervasive impact on control effectiveness in business or financial processes at the business unit level A control issue relating to any fraud committed by any member of senior management or any manager who plays a significant role in the financial reporting process 	<ul style="list-style-type: none"> Actual or potential financial statement misstatements > \$5 million Control issue that could have an important impact on control effectiveness in business or financial processes at the business unit level 	<ul style="list-style-type: none"> Actual or potential financial statement misstatements < \$5 million Control issue that does not impact on control effectiveness in business or financial processes at the business unit level
<i>Operational Controls (Effectiveness and efficiency of operations)</i>	<ul style="list-style-type: none"> Actual or potential for public censure, fines or enforcement action (including requirement to take corrective actions) by any regulatory body which could have a significant financial and/or reputational impact on the Group Any risk of loss of license or regulatory approval to do business Areas of non-compliance identified which could ultimately lead to the above outcomes <p>A control issue relating to any fraud committed by any member of senior management which could have an important compliance or regulatory impact</p>	<ul style="list-style-type: none"> Actual or potential for public censure, fines or enforcement action (including requirement to take corrective action) by any regulatory body Areas of non-compliance identified which could ultimately lead to the above outcomes 	<ul style="list-style-type: none"> Actual or potential for non-public action (including routine fines) by any regulatory body <p>Areas of noncompliance identified which could ultimately lead the above outcome</p>
<i>Compliance Controls (Compliance with applicable laws and regulations)</i>	<ul style="list-style-type: none"> Such an issue would be expected to receive immediate attention from senior management, but must not exceed 60 days to remedy. 	<ul style="list-style-type: none"> Such an issue would be expected to receive corrective action from senior management within 1 month, but must be completed within 90 days of final Audit Report date. 	<ul style="list-style-type: none"> Such an issue does not warrant immediate attention but there should be an agreed program for resolution. This would be expected to complete within 3 months, but in every case must not exceed 120 days.
<i>Remediation timeline</i>	Such an issue would be expected to receive immediate attention from senior management, but must not exceed 60 days to remedy.	Such an issue would be expected to receive corrective action from senior management within 1 month, but must be completed within 90 days of final Audit Report date.	Such an issue does not warrant immediate attention but there should be an agreed program for resolution. This would be expected to complete within 3 months, but in every case must not exceed 120 days.

Appendix 3

Distribution

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