AUDIT REPORT

Commissions

June 27, 2016

Report Number: OIA-2016-04-Commissions

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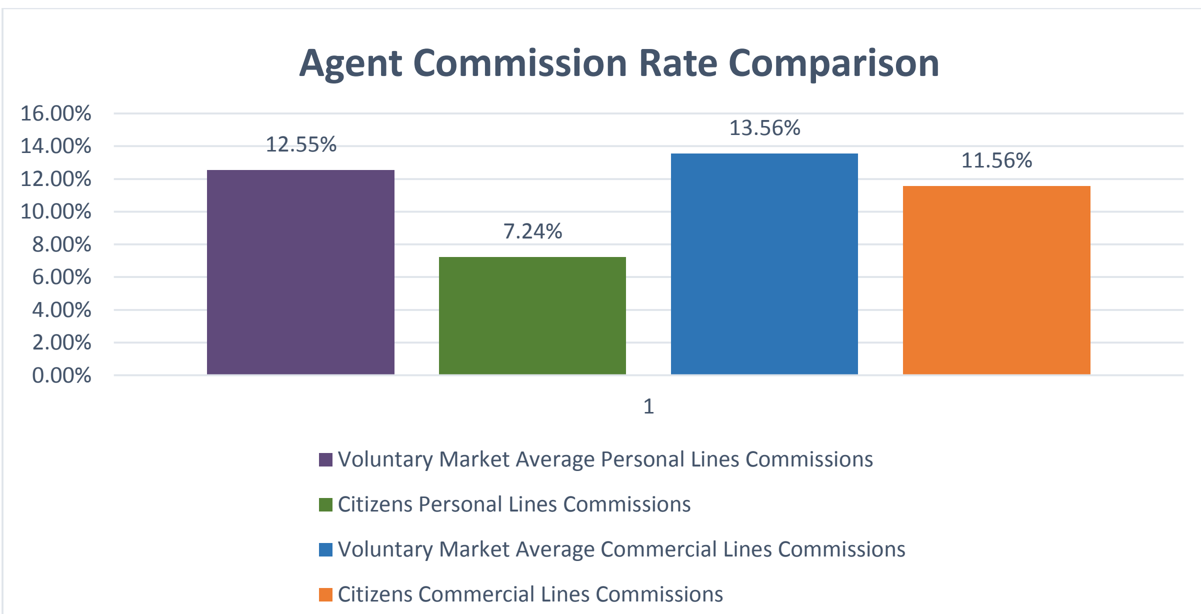
Executive Summary

Background

Citizens provides insurance products and services through a distribution channel of licensed insurance agents to Florida policyholders who are unable to find property insurance coverage in the private market. These agents are paid a commission for the service of new and renewal policies placed with Citizens. Agent commission rates are a fixed percentage of the policy premium paid by the policyholder minus mandatory surcharges and assessments. The commission percentage may vary depending on certain factors such as line of business, risk classification and where the property is located in Florida. As of April 2016, Citizens had appointed approximately 7,933 licensed agents associated with 5,187 agencies.

The commission rates paid on personal residential multi-peril policies and personal residential policies without wind coverage are paid at an effective of 7.4% and 9.6% respectfully. Agents writing a residential wind-only policy are paid at an effective commission rate of 8.1%. Commissions paid on commercial residential and non-residential wind-only policies are paid at an effective rate of 11.4% and 11.3% respectfully. Commissions paid on commercial non-residential wind-only and non-residential multi-peril policies are paid at an effective rate of 12% and 6.9% respectfully.

Citizens' commission structure compensates agents at a lower rate compared to the voluntary market based on a study that was performed by the Florida Association of Insurance Agents (FAIA) in 2012. FAIA compared the commission levels of Citizens to those paid by several commercial and personal insurance carriers in Florida. The study determined that Citizens pays less commission as percentage of premium than any other private carrier for personal lines policies (both new and renewal), and is significantly below the statewide average for the private market in both personal and commercial lines. The bar graph below breaks down the commission rate paid by Citizens versus the private market.



Source: Florida Association Insurance Agents (FAIA): Citizens Producer Compensation Presentation 2012

Commissions are automatically calculated by BillingCenter (which is a component of the Citizens Insurance Suite) based on the commission rates and the premium for the policy period. In 2015, Citizens paid $103M in agent commissions on 503,865 policies in-force (PIF) as of 12/31/2015 compared to

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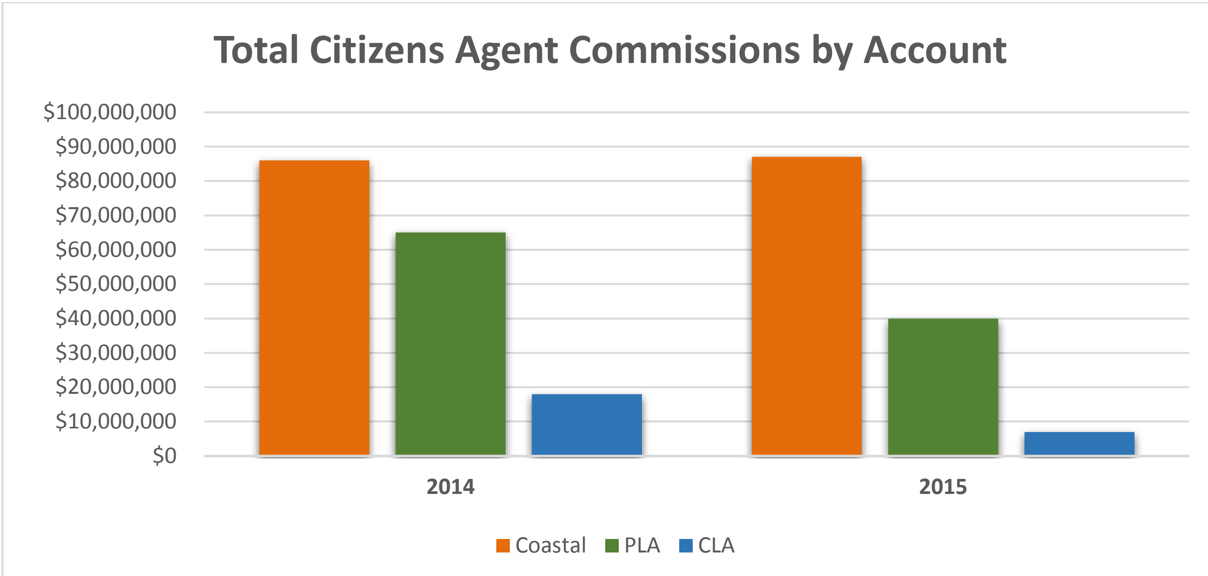
$170M on 661,161 policies in-force as of 12/31/2014, which represents a 39% decrease due to a reduction in direct written premium resulting from depopulation and clearinghouse activities. The bar graph below breaks down the commissions paid by account.



Commercial lines polices (CLA) and some Coastal policies were renewed, from the prior system, onto the new Citizens Insurance Suite policy system from October 2013 through September 2014. In addition, Personal lines polices (PLA) and the remaining Coastal policies were renewed, from the prior system, onto the new Citizens Insurance Suite policy system from December 2014 through November 2015. OIA monitored the Citizens Insurance Suite development and performed many pre and post implementation reviews throughout the multi-year implementation. As the migration of policies from legacy systems to the Citizens Insurance Suite has been completed, OIA through our risk assessment process determined it was prudent to validate the processes and controls supporting the strategy, calculation and payment of commissions through the new system.

Audit Objectives and Scope

The objective of this audit is to evaluate whether the key controls associated with commission rates and calculations are efficient and effective to ensure that commissions paid to agents are accurate, authorized and timely. Our scope included a review of the following areas:

- Commission strategy alignment
- Validation of agent commission rates
- Commission rate change control process for BillingCenter
- Testing of commission calculations for each policy type
- Access to Electronic Funds Transfer (EFT) and commission check disbursement files
- Access to the production environments related to the commission process
- Access to BillingCenter and PolicyCenter in the Insurance Suite

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Audit Opinion

The overall effectiveness & efficiency of the procedures and related processes associated with the commission rates and calculations are considered **Needs Minor Improvement**.

Results from our audit work indicate that the key controls around the commission rates and calculations are adequate in ensuring that commissions paid to agents are accurate, authorized and disbursed in a timely manner. In addition, the processes and controls supporting the commission strategy are well designed and operating effectively.

Our work also indicated specific areas where opportunities for improvement were noted:

- **The need to review roles and permissions assigned to users in BillingCenter.** Review of the security roles in BillingCenter revealed that 49 IT personnel were assigned roles and permissions that were in conflict with their current job responsibilities. Excessive access could result in unauthorized changes, which increases the opportunity for fraudulent activity, potentially leading to financial loss. Management has completed the action plan.

- **The need to manage administrative access to select production databases.** There is a considerable number of IT personnel who have full administrative access to select production databases and activity for these individuals is not monitored. Inappropriate access to these databases could result in unauthorized modifications, which increases the opportunity for fraudulent activity, potentially leading to financial loss.

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

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 effective. 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 or 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
Financial Controls (Reliability of financial reporting)	• 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	• 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	• 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
Operational Controls (Effectiveness and efficiency of operations)	• 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 • A control issue relating to any fraud committed by any member of senior management which could have an important compliance or regulatory impact	• 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	• Actual or potential for non-public action (including routine fines) by any regulatory body • Areas of noncompliance identified which could ultimately lead the above outcome
Compliance Controls (Compliance with applicable laws and regulations)	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.
Remediation timeline	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

Addressee(s)	Matt Gerrell, Assistant Controller Aditya Gavvala, VP Application Delivery Carl Rockman, Director Agency Management
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