

Office of the Internal Auditor



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AUDIT REPORT

Coinsurance Process Audit

September 13, 2016

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Executive Summary

Background

The property insurance industry utilizes coinsurance as a standard tool to manage risk in situations where a property may be underinsured. Coinsurance simply stated, is a promise by the policy holder to insure the property to adequate value. If that promise is not kept the property owner becomes a “co-insurer” and shares in the cost in the event of a loss. Citizens, in alignment with the industry, employs coinsurance terms in a majority of commercial policies. Historically coinsurance has been a point of confusion between the policy holder and insurance companies to the extent that the State of Florida has specific statutes that outline how coinsurance can be applied and communicated. Citizens uses industry standard language to ensure compliance with state statutes and to ensure coinsurance terms are clearly represented to policy holders.

The concept of coinsurance essentially provides Citizens with a means to assure that the proper premium is received for the risk that is assumed. The coinsurance provision accomplishes this by specifically laying out the outcome in the event that a property is not adequately insured at the time of a claim.

Citizens’ coinsurance provision outlines three value thresholds for the policy holder to choose from as a percentage of total insurance to value (ITV), either 80, 90 or 100% in alignment with industry standards. To illustrate how the coinsurance provision can be applied the following examples have been taken from Citizens Commercial Property Building and Personal Property Coverage Form provided to all coinsurance policyholders.

EXAMPLE #1 (UNDERINSURANCE)

When: The value of the property is: \$ 250,000
The Coinsurance percentage for it is: 80%
The Limit of Insurance for it is: \$ 100,000
The Deductible is: \$ 250
The amount of loss is: \$ 40,000

Step (1): $\$250,000 \times 80\% = \$200,000$

(the minimum amount of insurance to meet your Coinsurance requirements)

Step (2): $\$100,000 \div \$200,000 = .50$

Step (3): $\$40,000 \times .50 = \$20,000$

Step (4): $\$20,000 - \$250 = \$19,750$

We will pay no more than \$19,750. The remaining \$20,250 is not covered.

Coinsurance provision for underinsurance

EXAMPLE #2 (ADEQUATE INSURANCE)

When: The value of the property is: \$ 250,000
The Coinsurance percentage for it is: 80%
The Limit of Insurance for it is: \$ 200,000
The Deductible is: \$ 250
The amount of loss is: \$ 40,000

The minimum amount of insurance to meet your Coinsurance requirement is \$200,000 ($\$250,000 \times 80\%$). Therefore, the Limit of Insurance in this example is adequate and no penalty applies. We will pay no more than \$39,750 ($\$40,000$ amount of loss minus the deductible of \$250).

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Policies with commercial coinsurance represent a material segment of Citizens book of business as 94% of all commercial policies underwritten by Citizens includes coinsurance terms. As of June 2016 commercial policies account for 23.6% of all Citizens exposure by dollar amount and 4.1% by policy count. The following chart shows the composition of commercial policies with coinsurance by exposure dollar amount, product line and coinsurance coverage type as of June 2016.

Program	Policies In Force	80%	90%	100%	No Coinsurance	Grand Total
Commercial Non Residential-Multi Peril	1,223				924,738,119	924,738,119
Commercial Non Residential-Wind	12,154	3,165,554,817	1,326,496,249	805,544,922	3,148,564,795	8,446,160,783
Commercial Residential-Multi Peril	1,874	676,530,049	1,463,562,435	7,716,857,475		9,856,949,959
Commercial Residential-Wind	4,920	1,886,671,894	2,932,153,358	8,203,237,689		13,022,062,941
Grand Total	20,171	5,728,756,760	5,722,212,042	16,725,640,086	4,073,302,914	32,249,911,802
		18%	18%	52%	13%	100%

Audit Objectives and Scope

The objective of this audit was to review and assess whether the coinsurance valuation determination process design and controls across Underwriting and Claims are adequate. Our scope included a review of the following areas:

- Review the coinsurance process design and assess its alignment with management's objectives.
- Review the coinsurance process and assess compliance with Florida insurance statutes.
- Review the coinsurance process and verify that process oversight, operational controls, and documentation are sufficiently incorporated to mitigate process risks.
- Review the coinsurance process implementation plan.

The first phase of the enhanced coinsurance process was implemented in the third quarter of 2016. Given the limited timeframe and population of coinsurance claims, substantive testing of the efficiency and accuracy of coinsurance transactions would not be practical at this time and as such was not in scope for this audit.

Audit Opinion

The overall effectiveness of the processes and controls with regards to the Coinsurance Valuation Referral process evaluated during the audit is rated as **Satisfactory**.

We found the Coinsurance Valuation Referral process well designed. Through interviews with Claims and Underwriting management and examination of the process, procedures and documentation we noted a methodical and reasonable approach which will strengthen Citizens Commercial Coinsurance position in the event of litigation. The Coinsurance process is supported

Executive Summary

by existing monitoring and reporting process in ClaimsCenter and PolicyCenter systems to ensure coinsurance terms are evaluated and enforced.

Prior to the Audit, Management undertook proactive steps to enhance and improve the coinsurance valuation referral process between Claims and Underwriting. The process enhancement resulted in greater automation, coordination and improved control documentation. We encourage management to maintain the process enhancement implementation timeline, and continue their efforts to automate the process. In addition, we encourage management to maintain consistency and continuity of the process between Claims and Underwriting.

We would like to thank management and staff in Underwriting and Claims 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:

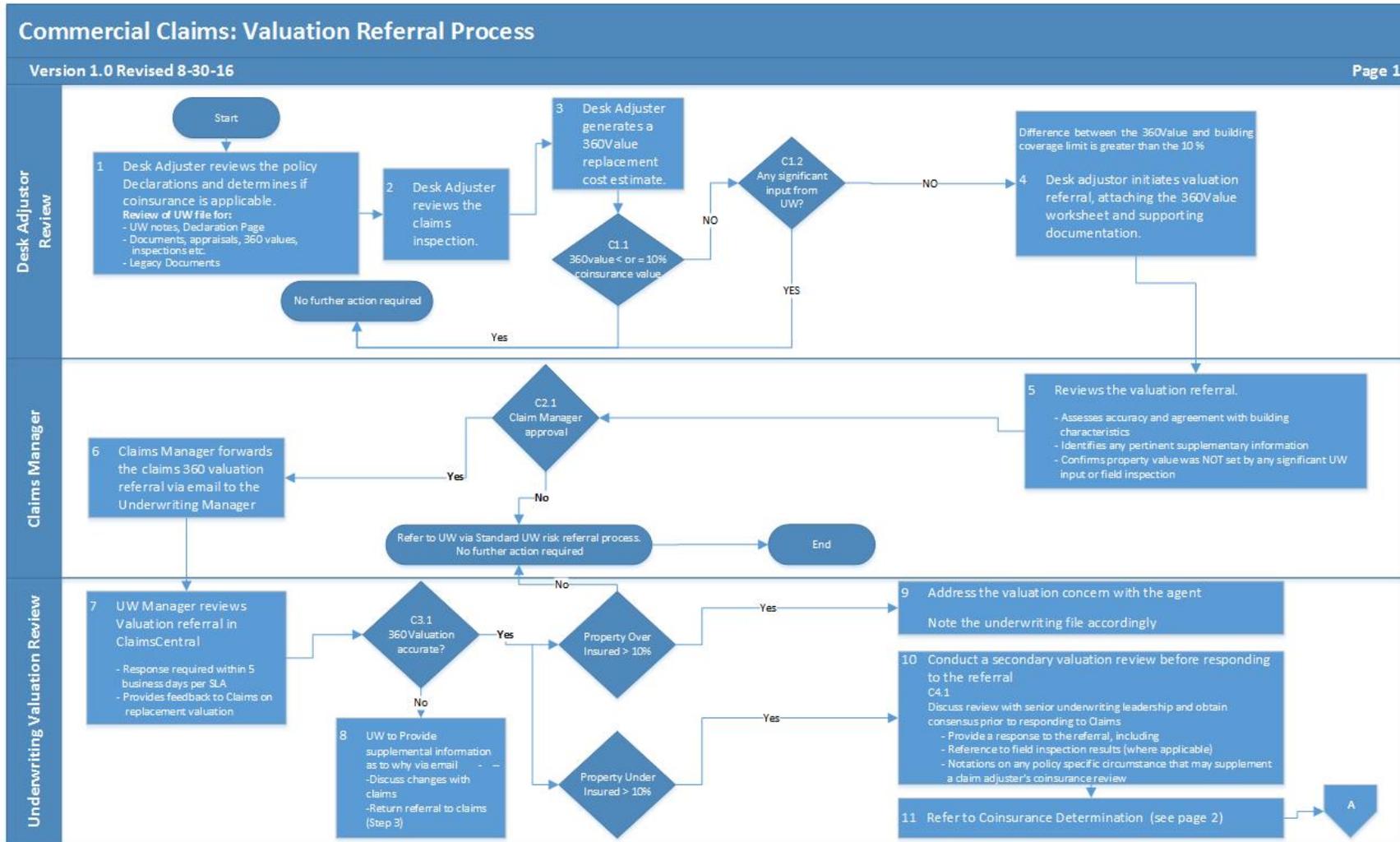
The audit raises questions regarding the appropriateness of the control environment and its ability to maintain risks within acceptable parameters. The control environment will require meaningful enhancement before it can be considered as fully satisfactory. The number and severity of issues relative 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.

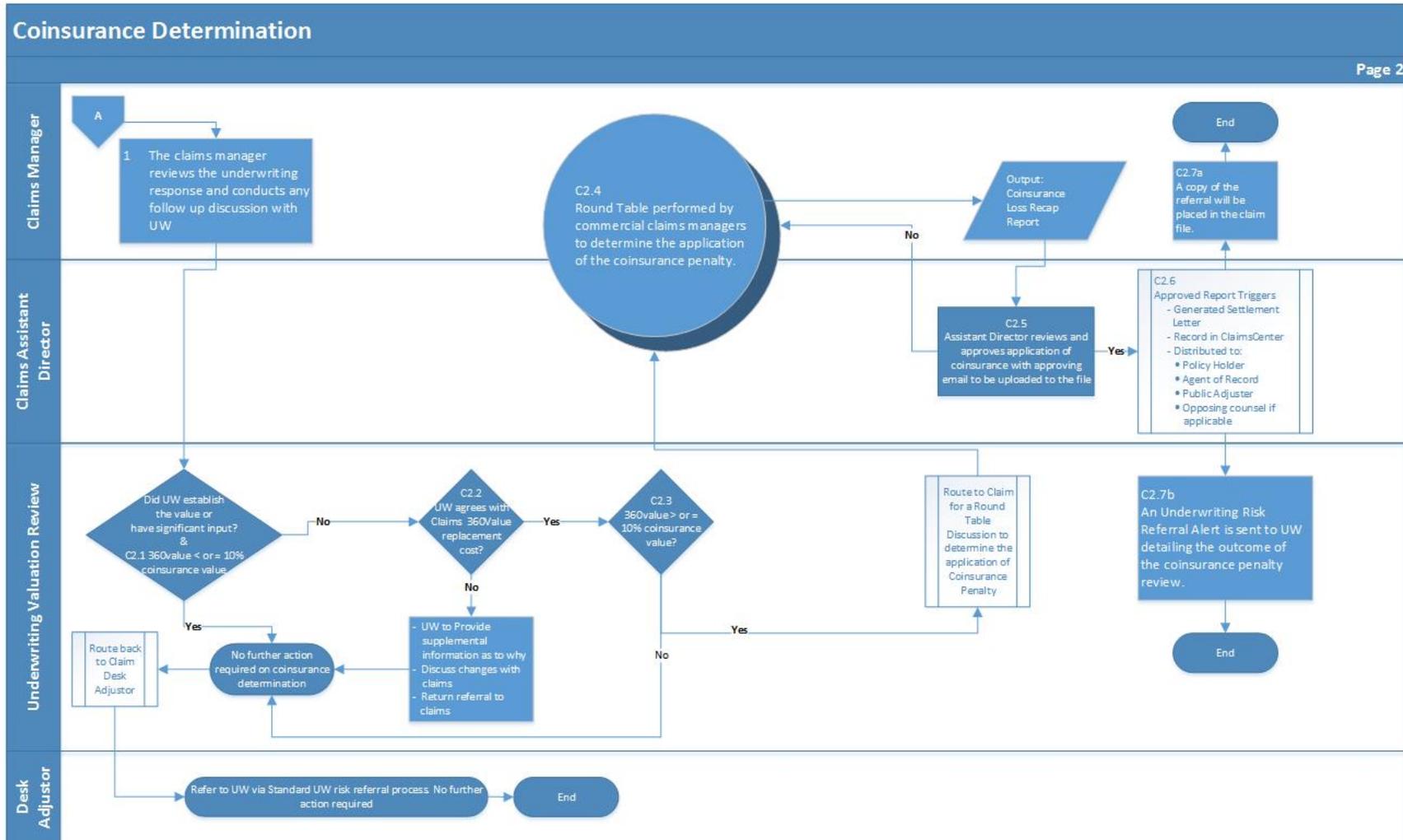
Appendix 2

Commercial Claims Valuation Process Map pg1



Appendix 2

Commercial Claims Valuation Process Map pg2



Appendix 3

Distribution

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