

Office of the Internal Auditor

ADVISORY MEMORANDUM February 2023

Agents Professional Liability





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Background

As of June 30, 2022, Citizens had 10,129 appointed agents, who, pursuant to the Agent Appointment Agreement (“the Agreement”), have the authority to bind policies with Citizens as set forth in the corporation’s guidelines. With the continued growth of policies in force, the likelihood of having uninsurable risks due to errors or omissions by agents increases. This could result in unnecessary financial exposure whenever these uninsurable risks file claims.

Through Errors & Omissions (E&O) coverage, Professional Liability insurance policies provide protection against claims for damages caused by errors, oversights, and/or failures that would typically be excluded under a traditional Commercial General Liability (CGL) policy as they occur while performing professional duties.

Objectives and Scope

OIA has been asked to provide advisory services and insight for a solution process designed to identify, evaluate, and potentially take action in instances where agents have committed errors or omissions by binding Citizens to uninsurable risks, resulting in claims and payments that Citizens’ would not have otherwise incurred.

Errors and Omissions Coverage (E&O)

Some types of Professional Liability coverages may be specific to an industry, a role, or a profession, such as Directors & Officers (D&O), Errors & Omissions, Medical Malpractice, and Legal Malpractice, among others. In some circumstances, and depending on the insurance carrier, the terms Professional Liability and Errors & Omissions may be used interchangeably. Coverage can be written under labels such as Agents & Brokers Professional Liability, Errors & Omissions Coverage, or with other custom names.

Notwithstanding, subject to the terms and conditions of the carrier’s form, E&O insurance is designed to provide professionals with coverage for economic damages caused by errors or omissions committed while performing professional duties or providing professional services. The coverage is ordinarily written on a “claims-made” basis, which differs from “occurrence” type policies such as the CGL, as coverage is provided when both the act (or omission) and the claim itself occur during the policy period and only while the policy remains in force. A “Prior Acts” or “Retroactive Date” endorsement may provide the professional or entity coverage for acts or omissions occurring before the policy period. An “Extended Reporting Period” endorsement may give the policyholder additional time to report the claim. E&O policies may contain high deductibles or self-retention limits, and coverage limits may include claims expenses.

Internal Audit reviewed three (3) samples of E&O policies received from Agents. These samples correspond to policies issued by National Union Fire Insurance Company of Pittsburg, PA, Swiss Re, and Hiscox Insurance Company, respectively. They consist of the



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declarations pages and do not contain the carriers’ specific E&O coverage forms. Below is a summary of the information:

| | |
|---------------|---|
| Insurer: | National Union Fire Insurance Company of Pittsburg, PA |
| E&O Coverage: | \$2M for each Wrongful Act / \$6M Aggregate / \$1,000 Deductible per Wrongful Act. Dec. page notes that the policy is a Claims-Made and Reported policy. Coverage forms are not listed. No retroactive date or extended reporting period is shown. |

| | |
|---------------|---|
| Insurer: | Swiss Re Corporate Solutions America Insurance Corp. |
| E&O Coverage: | \$2M per claim / \$4M Aggregate / \$5,000 Deductible per claim. Dec. page notes that the policy is a Claims-First-Made policy. Coverage forms are not listed. No retroactive date or extended reporting period is shown. |

| | |
|---------------|--|
| Insurer: | Hiscox Insurance Company, Inc. |
| E&O Coverage: | \$2M per claim / \$2M Aggregate / \$500 Deductible per claim E&O coverage is provided pursuant to form DPL D001 CW (11/19) on a Claims-Made and Reported basis with claims expenses included within the limit of liability. Dec. page also shows Professional Liability Coverage Form and Insurance Agent Services Endorsement, among other endorsements included in the policy. No retroactive date or extended reporting period is shown. |

Results

Internal Audit met with staff from several business units (Corporate Legal, Claims Legal, Special Investigation Unit (SIU), Recoveries, Claims Litigation, Communications & Strategic Services) to gain knowledge regarding the agent relationship, current processes, and concerns, and to understand the potential operational and reputational impact of pursuing recovery against the agent’s E&O insurance policy and/or the agent or agency.

Citizens’ Agents need to meet several requirements prescribed by law and adopted by the Board of Governors, which include:

- Have an active 2-20 or 20-44 Florida resident agent's license or 9-20 or 90-44 non-resident agent's license in good standing with the Department of Financial Services.
- The agent must be appointed with at least one insurer authorized to write new personal residential, commercial residential, or commercial nonresidential property coverage in Florida.
- If the agent was previously terminated by Citizens for cause, he/she is not eligible to apply within two years of their termination date.



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Once Agents complete the application process¹, they are required to sign “the Agreement”, which delineates the terms and obligations of the Agents as part of their appointment. As part of “the Agreement”, Agents have binding authority, as limited by the “Agent Guidelines”, which are defined as and comprised of Underwriting Manuals, Agent Bulletins, Citizens’ Plan of Operation, and other official publications which are communicated to Agents from time to time and set forth Citizens’ official policies and/or requirements. The current Agreement dates from 2016, and we understand it is currently under review.

As part of the General Requirements of “the Agreement”:

- Agents agree to fully comply with the underwriting submission requirements:

IV. Operational Requirements

A. Underwriting Submissions. The Agent understands and agrees that full compliance with underwriting submission requirements is critical to meeting his or her responsibilities to Citizens and that such requirements will be strictly enforced. Agent agrees, therefore, to submit all risks to the Citizens' Clearinghouse, where applicable; and to ensure that all applications and other underwriting submissions are complete, accurate and submitted in accordance with applicable Agent Guidelines. The Agent understands and agrees that the requirement for the submission of complete and accurate applications is a condition of binding authority and that Citizens may institute procedures whereby incomplete or inaccurate application submissions are only conditionally bound. The Agent agrees to cooperate with and assist Citizens in obtaining any additional underwriting-related information. All applications must be signed by the applicant(s), unless the signor has a valid, written Power of Attorney. A complete and signed copy of the application must be provided to the applicant at the time of application. Only the Appointed Agent may sign the application where indicated for the Agent’s signature. The Agent acknowledges that Citizens may require, as part of the underwriting submission process, documents in addition to the application, which require both the signature of the applicant and an attestation by the agent.

- Agents must be covered under the Agency’s E&O policy, which requires limits of at least \$1 Million per occurrence² and \$1 Million in general aggregate:

II. General Requirements

D. Errors and Omissions Insurance. At all times during the term of this Agreement, the Agent must be covered under the Agency’s Errors and Omissions insurance policy. The policy must be issued by an insurer authorized to transact insurance in Florida or by an eligible surplus lines insurer. The insurer shall have a financial strength rating of at least “B+” (good) by A.M. Best Company. The Agent agrees to provide proof of compliance with this Errors and Omissions coverage

¹ See [Agency Appointment Application - Public - Citizens Property Insurance Corporation \(citizensfla.com\)](https://citizensfla.com)

² While “the Agreement” specifies “per occurrence”, E&O policies are typically written in a “claims made” basis, which is discussed further in this memorandum.



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requirement upon request. The coverage limits must be at least \$1 million per occurrence and \$1 million annual aggregate.

- Furthermore, the General Terms and Conditions of “the Agreement” contain an indemnification agreement, which reads as follows:

VII. General Terms and Conditions

G. Indemnification. The Agent shall indemnify and hold harmless Citizens, its Board Members, employees, designees, committees and committee members from any liability, damage, claims or causes of action, in law or in equity, with regard to any and all losses, claims, damages, fees and expenses, including legal fees or other expenses reasonably incurred or paid by Citizens on account of: 1) any negligent or wrongful act, error or omission of the Agent in the rendering of services pursuant to this Agreement, except to the extent that Citizens has caused such liability or damage, 2) any action brought by an insurance agency or any other third party against Citizens pertaining to the ownership, custody, or control of any Customer Records or Citizens business produced or serviced by the Agent, provided that Citizens is not found to have acted negligently or wrongfully with regard to such matter, and 3) the investigation of any Security Incident and any reasonable efforts to respond to such Security Incident, as set forth in Section III (above), provided that Citizens is not found to have acted negligently or wrongfully with regard to such matter. Citizens shall indemnify and hold harmless the Agent from any liability, damage, claims or causes of action with regard to any and all losses, claims, damages, fees and expenses, including legal or other expenses reasonably incurred or paid by the Agent on account of any negligent or wrongful act of Citizens in the performance of any duty set forth in this Agreement except to the extent that the Agent caused such liability or damage.

The recovery process filed against E&O insurers is not foreign to Citizens as it has occurred in the past; however, there is no formal process for the identification and pursual of these actions. Currently, SIU and Corporate Legal have had a procedure in place since around 2021 to manage Agents’ E&O claims subsequent to an SIU investigation. Interviews with various groups and the review of documentation as part of this engagement did not identify any agreement as to where the procedure should reside, and efforts were to be made to identify talent versed in the malpractice field.

In the meanwhile, Agent Administration and Compliance has established a procedure to refer cases involving claims concerning uninsurable risks to the SIU. They have noted that in some instances, these types of claims may be filed before policy cancellation or when they go through the auto-underwriting process (AUW). For this reason, the unit keeps track of this information and compiles an excel report that pulls data from instances where performance violations have generated property claims. Underwriting considers a performance violation for those instances that do not comply with the Underwriting



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Guidelines, and these can occur when the document submission process is circumvented or when agents submit ineligible or uninsurable risks.

A small sample of 8 performance violations/claims from the latest report (December 2022) was reviewed. This sample showed that the total paid for the claims was \$250,338.50, with payments ranging from \$325.00 to \$113,057.67.

Opportunities for Improvement

Following the completion of our review, we noted the following opportunities for improvement for Management's consideration:

- **Review the Agent Appointment Agreement** – Management should consider setting the Agreement for periodic revision and update it as required to incorporate market conditions or changes, lessons learned, and regulatory changes, among others.

With regard to the subject matter, Management may want to consider reviewing and updating the “Errors and Omissions Insurance” section as follows:

- Consider substituting “per occurrence” for “per claim.” This could help avoid any confusion with “occurrence”-type policies.
 - Determine the appropriateness of “per claim” and “aggregate” amounts.
 - Consider adding a retroactive date requirement. This could help find coverage for acts, errors, or omissions that may be deemed to have taken place during a prior E&O policy period.
 - Evaluate the requirement to add Citizens as an “Additional Insured” in the Agent’s E&O policy.
 - Require prompt notice of any changes, cancellations, or termination of the E&O coverage. This could help strengthen the Agents’ obligation when these events occur before the appointment renewal.
- **Formal Reporting** – Agent Administration & Compliance has a procedure to identify uninsurable risks with claims and has created an excel report to track. Management should consider making this a customized PowerBI report containing information pertinent to the risk and the loss, including agent name, policyholder, loss description, claim status, and amounts paid, among others. The report would help identify and escalate matters timely and be used for tracking.
 - **Counsel for Recovery** – Currently, outside counsel utilized by Citizens for subrogation and recoveries is hired on a contingency basis, which could cost up to 30%. Citizens could benefit from having in-house or inside counsel handle the recovery, depending on the facts and complexity of the claim. Nonetheless, in-house counsel may be able to initiate the claim or action letter to the Agent and their E&O carrier, as well as interact with the carrier as necessary to attempt recovery without unnecessary litigation expenses.



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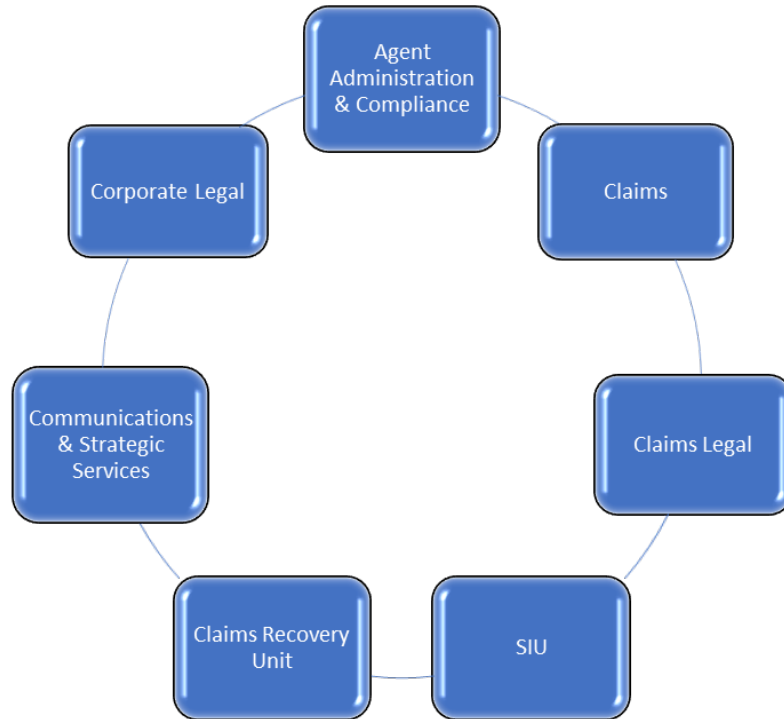
- **Creation of Recovery Evaluation Workgroup** – As potential E&O recovery instances involve various elements (a contract, a claim associated with an agent’s performance violation, a file with an investigation, an agent relation, and a potential action, etc.), Management should consider having these elements evaluated by a workgroup composed of members from several business units. The workgroup should establish the criteria that would trigger the recovery process, develop the initial communication informing the agent (and carrier) of the claim, identify appropriate outside counsel (if needed), and establish the recurrence of meetings. Factors such as frequency, severity, complexity, cost-benefit, and outstanding recovery matters should be considered for these activities.

Internal Audit suggests the following approach, which assumes that the potential action arises out of a paid claim (non-litigated):

- **Agent Administration & Compliance** – Provide input regarding the agent relationship, the Agreement, policy violations (historical), the ineligible risk, actions taken, and any other pertinent information/documentation.
- **Claims** – Provide and discuss the claim file under which payment was issued in connection with the ineligible risk.
- **Corporate Legal** – Evaluate the Agreement *vis a vis* the potential claim and provide legal input as appropriate in relation to the particular matter(s), including agent termination.
- **Claims Legal** – Provide legal input as necessary regarding the potential recovery, venue, and parties, among others. Determine if in-house / inside counsel will handle the matter.
- **SIU** – Provide input and pertinent information/documentation, as appropriate, regarding any investigations concerning the parties involved, including information on any system-generated referrals for Claims within 30 days of policy inception, if applicable.
- **Communications & Strategic Services** – Provide input on the potential reputational impact of pursuing recovery in a particular instance.
- **Claims Recovery Unit** – Provide input and support to allocate recoveries and expenses in connection with the particular matter(s) in Citizens’ systems.



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Additional Concerns and Things to Consider:

The following potential scenarios or issues came up during this engagement and should be considered as part of any adopted process:

- Citizens’ Recovery unit and/or the current pool of counsel may not have the expertise to handle E&O cases.
- Citizens would be putting a confidential claim at issue, potentially subjecting the policyholder to a deposition.
- Underwriting Guidelines would be an issue and could be subject to discovery. While ISO deems these proprietary, Corporate Legal noted that Citizens has previously dealt with them in discovery.
- Agents / Agencies could claim that Citizens should not have issued payment on the claim and that they should not be held responsible.
- E&O Carrier may deny coverage to the Agent. This could happen for several reasons. Some examples are:
 - An E&O policyholder is typically required to report the potential claim as soon as it is known or reported. Failure to do so may result in a coverage denial.
 - The E&O carrier may consider the Agent’s actions intentional, rather than an error or an omission, resulting in a coverage denial.
- If Citizens settles a claim with the Agent or with the E&O carrier, it could be barred from seeking additional funds if the policyholder is still within the statute of limitations to file



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a supplement claim or suit, and it is determined that these are owed. This could leave the door open for up to five (5) years (based on the statute of limitations for breach of contract). Additional considerations and complexities arise if the claim ends up being litigated by the policyholder.

Some of these concerns can be managed as part of the creation of a formal process if adopted, while others would have to be evaluated on a case-by-case basis.

With regards to the Agents' potential argument of not being responsible, as Citizens should not have paid the claim, Citizens' due diligence in reviewing the underwriting file and conducting the risk inspection process may play an important role, regardless of the Agreement's indemnification language. Citizens' due diligence would help identify these ineligible risks promptly and take appropriate action timely. However, some of these uninsurable risks may not be identified until a claim is filed and the condition(s) that made it ineligible show up during the Claims process.

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



Distribution

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