

CERTIFIED MAIL  
RETURN RECEIPT REQUESTED

STATE OF ALASKA  
DEPARTMENT OF COMMERCE, COMMUNITY AND ECONOMIC DEVELOPMENT  
DIVISION OF INSURANCE  
PO BOX 110805  
JUNEAU, AK 99811-0805

Order # TA 08-01 )  
In the Matter of Audit of )  
The Insurance Center )  
\_\_\_\_\_ )

FINDINGS OF FACT

1. An audit report of The Insurance Center, licensed in the state of Alaska, has been issued by the State of Alaska, Division of Insurance to The Insurance Center.
2. The audit report of The Insurance Center (TA 08-01) has been transmitted to Phil Mink, Compliance Officer, The Insurance Center (Auditee), and Auditee has been accorded at least 30 days' opportunity to review and comment on this audit report.
3. The director of the Division of Insurance has fully considered and reviewed the report and any relevant portions of the auditor's work papers to the extent she considered necessary.

CONCLUSIONS OF LAW

1. The written audit report referred to in Finding of Fact No. 1 was issued in accordance with Alaska Statute (AS) 21.06.150(b).
2. The actions set forth in finding of Fact No. 2 were conducted in accordance with AS 21.06.150(b).
3. The director of the Division of Insurance has reviewed the audit report and any other relevant work papers as set forth in Finding of Fact No. 3 to the extent she considered necessary in accordance with AS 21.06.150(b).

ORDER

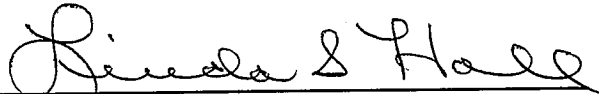
IT IS ORDERED

1. Pursuant to AS 21.06.150(b)(1), the audit report of The Insurance Center (TA 08-01) is approved as filed.

2. Pursuant to AS 21.06.060, the audit report shall be kept in the office of the director of the Division of Insurance and be open to public inspection.

This order is effective Aug. 11, 2008.

Dated this 11<sup>th</sup> day of August, 2008 at Anchorage, Alaska.



Linda S. Hall, Director  
State of Alaska  
Division of Insurance

**PREMIUM TAX AUDIT OF**

**The Insurance Center  
Anchorage, Alaska**

**TA 08-01**

**As of December 31, 2007**

**Issued by  
DIVISION OF INSURANCE  
DEPARTMENT OF COMMERCE, COMMUNITY AND ECONOMIC  
DEVELOPMENT  
STATE OF ALASKA**



**FINAL REPORT:  
August 11, 2008**

**TABLE OF CONTENTS**

	PAGE
1) TABLE OF CONTENTS.....	2
2) SALUTATION .....	3
3) SCOPE OF AUDIT.....	3
4) METHODOLOGY .....	4
5) PREMIUM TAX AUDIT .....	5
6) SUMMARY AND SUBSEQUENT EVENTS .....	11
7) AFFIDAVIT .....	13



STATE OF ALASKA  
DEPARTMENT OF  
**COMMERCE**  
COMMUNITY AND  
ECONOMIC DEVELOPMENT

*Sarah Palin, Governor  
Emil Notti, Commissioner  
Linda S. Hall, Director*

Division of Insurance

August 11, 2008

Linda S. Hall, CPCU  
Director, Division of Insurance  
Department of Commerce, Community and Economic Development  
550 West 7<sup>th</sup> Avenue, Suite 1560  
Anchorage, AK 99501-3567

Pursuant to Alaska Statute (AS) 21.06.130, the Alaska Division of Insurance performed a limited and targeted premium tax audit of The Insurance Center (the broker) on March 18, 2008 through March 19, 2008, in the broker's Anchorage, AK office. The audit was conducted by Rebecca Nesheim, tax auditor for the Alaska Division of Insurance.

### **SCOPE OF AUDIT**

This premium tax audit was called to review compliance with the surplus lines statutes AS 21.34, regulations 3 AAC 25, and the premium tax regulations 3 AAC 21.550 – 570.

### **Subject Matters Audited**

The Insurance Center is an Alaska licensed surplus lines broker based in Anchorage, AK. The division elected to audit their monthly filings, premium taxes paid, and filing fees paid, for accuracy and timeliness as well as required due diligence and disclosures to the insured.

### **Time Frame**

The audit covered this broker's surplus lines business for the two years of January 1, 2006 through December 31, 2007.

P.O. Box 110805, Juneau, Alaska 99811-0805  
Telephone: (907) 465-2515 Fax: (907) 465-3422 Text Telephone: (907) 465-5437  
Email: [insurance@commerce.state.ak.us](mailto:insurance@commerce.state.ak.us) Website: <http://www.commerce.state.ak.us/insurance/>

## METHODOLOGY

The tax auditor sent the call letter and initial data requests to The Insurance Center's office in Anchorage. A list of all Alaska business transactions with nonadmitted insurers was requested for the period to be audited. The broker complied timely with all data requests. Ninety-eight policies were written during the audit period from which a sample of 50 files to audit was drawn randomly.

### *The following are the procedures steps for the audit:*

- 1) Verify that monthly premium reports and accompanying forms were filed in a timely manner.
  - i) Audit steps taken:
    - (1) Reviewed the monthly files sent to the Alaska Division of Insurance and verified the policy was included in the monthly filing based upon the effective date of the policy.
    - (2) Verified a statement of exempt premiums was filed when appropriate.
- 2) Verify the accuracy of the premium calculation
  - i) Audit steps taken:
    - (1) Reviewed policy, declaration page, and invoices to determine how they calculated the premium.
    - (2) Verified the correct premium was reported on the monthly reports as filed.
- 3) Verify the accuracy of all monthly reports filed.
  - i) Audit steps taken:
    - (1) Reviewed the policy & declaration pages in each file.
    - (2) If the effective date did not match the monthly filing, reviewed the correspondence to ensure the documentation in the file matched when the policy was booked. Most of these occurred with endorsements that often require additional information and sometimes company approval before it can be added to the policy. The effective date may be a month or more prior to the actual book date or invoice date. In this case, the invoice date usually determined in which month the endorsement is required to be filed.
    - (3) Verified the monthly reports as filed with the division were accurately filled out to reflect the correct effective date, premiums, taxes and fees based upon the information in the files.
- 4) If the placement is a multi-state placement, check the calculation and reasonableness of the methodology to allocate.
  - i) Audit steps taken:
    - (1) Verified the allocation of premium for each state is reasonable and the calculation is accurate.
- 5) Verify quarterly and annual premium tax reports were filed in a timely manner.
  - i) Audit steps taken:
    - (1) Confirmed when the quarterly and annual premium tax reports were mailed to the Alaska Division of Insurance.
- 6) Verify the accuracy of the quarterly and annual premium tax reports
  - i) Audit steps taken:

- (1) Verified the quarterly and annual premium tax reports as filed with the division were accurately filled out to reflect the correct premiums, taxes and fees based upon the monthly reports filed.
- 7) Verify if tax and filing fee payments were made timely and by ACH
  - i) Audit steps taken:
    - (1) Confirmed when the payments were made to the Alaska Division of Insurance and the payment method
- 8) Verify tax and filing fees payments were made accurately
  - i) Audit steps taken:
    - (1) Confirmed if the tax and fee payments matched the tax reports as filed.
- 9) Review effort made to place insured with an admitted insurer
  - i) Audit steps taken:
    - (1) Verified an affidavit of due diligence was in the file and the declinations filled out. If it was marked as using the placement list, the list effective at the time of placement was reviewed to ensure the risk was on the list
- 10) Review disclosures for use of non-admitted insurer per AS 21.34.100(e)
  - i) Audit steps taken:
    - (1) Reviewed the evidence of insurance to ensure the required broker information and stamp were visible.
- 11) Review disclosures for use of non-admitted insurer per AS 21.34.110
  - i) Audit steps taken:
    - (1) Reviewed the correspondence and other documentation in the files to find a copy of the notification sent to the insured that meets the requirement in AS 21.34.110
- 12) Confirm coverage is placed with an eligible non-admitted insurer
  - i) Audit steps taken:
    - (1) Reviewed the white lists to ensure the company was eligible at the time of placement
- 13) Review notice regarding nonrenewal and premium increase
  - i) Audit steps taken:
    - (1) Verified in each file there was a policyholder notice regarding nonrenewal and premium increase included with the policy.

**Acceptable Error Rate:**

The Broker's acceptable error rate for the above referenced standards and tests must be less than 10%.

**PREMIUM TAX AUDIT**

1. Verify that monthly premium reports and accompanying forms were filed in a timely manner.  
 AS 21.34.080 and .170, 3 AAC 25.100 and 25.090

*Comments:* Four of the 24 monthly premium reports and accompanying forms were filed late. Each monthly filing had the correct forms attached: monthly premium report summary and report of surplus lines transaction. Three of the late filed reports were prior to 6/11/06 when new regulations instituted a penalty for late filings. One report was filed late in 2007 for which the broker was assessed a late fee of \$100 that was paid timely.

*Result:* Failed (20 reports passed & 4 failed, error rate 17%)

*Recommendation:* It is recommended that the broker create written procedures to be followed when preparing and filing a monthly report to ensure the timeliness of future filings. Due dates should be included in the procedures.

*The Insurance Center response received June 9, 2008:* We fully intend to comply with the recommendations and make them visible in our electronic filing system.

**2. Verify the accuracy of the premium calculation**

**AS 21.34.180**

*Comments:* The premium was calculated correctly for every transaction in the audit files.

*Result:* Passed (error rate 0%)

**3. Verify the accuracy of all monthly reports filed**

**AS 21.34.080 and .170, 3 AAC 25.100 and 25.090**

*Comments:* A month end report from the computer system gives a list of insurance companies with which the policies were written and staff then creates the monthly reports from the computer report. The process is manual as the computer system does not prepare the reports for the broker. One policy transaction with an effective date of February 4, 2006 was filed on the March 2006 monthly report instead of the February 2006 report. This error does not affect any other tests in the audit. Some minor clerical mistakes were made on the reports that did not affect the taxes and fees reports or payments. Some of these mistakes on the report of surplus lines transaction form were the wrong effective date, wrong insurance company and the wrong premium. When the monthly premium report summary was filled out for those incorrect transaction forms, the correct information was captured and therefore did not affect any other audit test.

*Result:* Passed (49 files passed & 1 failed, error rate 2%)

*Recommendations:* It is recommended that the broker create written procedures for when initial or renewal policies as well as endorsements are to be reported to the Alaska Division of Insurance. Statute and regulation dates should be included in these new procedures. Following the written procedures will ensure all transactions are filed in the correct month. A review by a second individual might be considered in order to catch the mistakes before the paperwork is filed with the Division.

*The Insurance Center response received June 9, 2008:* We fully intend to comply with the recommendations and make them visible in our electronic filing system.



4. Verify the multi-state placements are filed correctly

AS 21.34.180

*Comments:* The broker does not write any multi-state policies.

Result: N/A

5. Verify quarterly and annual premium tax reports were filed in a timely manner

AS 21.34.180, 3 AAC 21

*Comments:* The broker is not required to file quarterly tax reports. The two annual premium tax reports were filed timely.

*Result:* Passed (error rate 0%)

6. Verify the accuracy of the quarterly and annual premium tax reports

AS 21.34.180, 3 AAC 21

*Comments:* The broker is not required to file quarterly tax reports. The 2006 annual premium tax report had a minor transposition error on it where an October transaction was reported in with the November premiums. As this was a net zero result between the two months and did not affect the tax and fees due, a revised report was not requested of the broker. The error found during the audit in the accuracy of the monthly reports affects the 2006 tax report as well. The 2007 annual premium tax report was accurate as received.

*Result:* Passed (error rate 0%)

7. Verify if tax and filing fee payments were made timely and by ACH

AS 21.34.180, 3 AAC 21

*Comments:* Although the broker was not required to pay quarterly tax and fees during 2006 and 2007, they chose to make quarterly payments of both tax and fees for both these years. All payments were made on or before the required due date for the annual payments and made by ACH.

*Results:* Passed (error rate 0%)

8. Verify tax and filing fees payments were made accurately

AS 21.34.180, 3 AAC 21

*Comments:* All tax and fee payments made by the broker were accurately based upon the tax reports as filed.

*Results:* Passed (error rate 0%)

9. Review effort made to place insured with an admitted insurer

AS 21.34.020, 3 AAC 25.030

*Comments:* Fourteen files did not contain an affidavit of due diligence, which is the mode of documentation the broker has chosen to use to meet regulations. Seven files had an affidavit but it was not received by the broker by either email, fax or mail until after the effective date of the policy, so after binding. One file contained an exception from the placement list from the Division but it was received after the bound date and is part of the seven files. On the late received affidavits, there was no documentation within the file of verbal discussions with the producers.

Some quotations listed in bold letters that an affidavit was required in order to bind. This was not followed up on when the broker failed to receive the affidavit.

Therefore, 21 files failed to show the efforts to place with an admitted insurer prior to binding.

*Results:* Failed (29 files passed & 21 failed, error rate 42%)

*Recommendations:* It is recommended that the broker create written procedures to ensure all affidavits of due diligence are received prior to binding. The procedures should include a policy of requiring a notation on quotations or indications that affidavits are required before a surplus lines policy can be bound. Then missing affidavits must be followed up on before binding.

*Summary of The Insurance Center response received April 10, 2008:* Before we offer a surplus lines quote, we confirm that coverage can't be written in any of our three admitted markets. We rely on the producing broker to provide an affidavit or evidence that coverage was not available in an admitted market. We will ensure both initial and concurrent coverages have the required affidavit or evidence in the file.

10. Review disclosures on evidence of insurance for use of non-admitted insurer

AS 21.34.100(e)

*Comments:* The broker uses two outdated stamps one of which is so large that it covers up words on the declarations (dec) page of some policies: "This contract is registered as a surplus lines coverage under the insurance laws of Alaska" and "This policy of insurance is not covered by the Alaska insurance guaranty association act."

The wording required by statute is: "This is evidence of insurance procured and developed under the Alaska Surplus Lines Law, AS 21.34. It is not covered by the Alaska Insurance Guaranty Association Act, AS 21.80." This statute requires a word-for-word notification exactly as stated in statute therefore the stamps used by the broker do not meet statute requirements.

Most policies are created in-house and are not scanned in after the stamp is manually applied to the hard copy sent to the producer for the insured. They make a notation on the electronic dec page that the stamp was on the hard copy. Several variations of this notation were found throughout the files that all mean the same thing:

- Red Stamped
- Red Stamped and Letter.
- Red Stamped & Lettered to Agent
- Red Stamped to Agent

Sometimes, the electronic notations get covered up or partially covered up by other notes that are used for workflow within the broker's electronic file system.

Binders never get the stamp as they are emailed after creation to the producers.

Since the stamps used were outdated and do not meet statute requirements, every one of the files failed. In addition, the test was taken a bit further to see if they documented use of the stamp correctly on their electronic files. Ten dec pages were missing the notification that the stamp was put on the hard copy of the policy. We have no way to confirm the stamp was or was not on the hard copy since they do not scan in that document, therefore we have to assume there was no stamp. Also, out of the 50 files, only 41 had electronic copies of binders, of which 100% did not have the required stamp.

*Results:* Failed for using wrong stamp (error rate 100%)

*Results:* Failed for missing notes on electronic dec pages (40 files passed & 10 failed, error rate 20%)

*Results:* Failed for no stamps on binders (error rate 100%)

*Recommendations:* It is recommended that the broker create written procedures for staff to ensure all evidence of insurance have the required stamp. The stamped dec page must be scanned into the electronic file record. An alternative solution is to add the required stamp language to all evidence of insurance prior to printing for the insured. This will reduce the requirement of scanning a stamped page into the electronic file and allow for emailing the document with the correct language on it, such as binders. Notes used in workflow must not cover up the statute language. In addition, new stamps should be purchased for stamping hard copies of evidence of insurance. Be sure to dispose of the old stamps.

*Summary of The Insurance Center response received April 10, 2008:* The wording in our oversized stamp is being corrected and made into a 10 point size. The required statement is now pre-printed in red on all our binders and policies. All mailed documents will be red-stamped with the appropriate wording and 10 point size. Insured's will be notified.

<p><b>11. Review notification for use of non-admitted insurer</b></p>
---

**AS 21.34.110**

*Comments:* The broker currently does not provide a notification to the insured that the insurer with whom the surplus lines broker places the insurance does not hold a certificate of authority issued by this state and is not subject to its supervision and, in the event of the insolvency of the surplus lines insurer, losses will not be covered under AS 21.80 (Alaska Insurance Guaranty Association Act). It is the brokers' responsibility to maintain in their file a copy of the notification that went to the insured either from them or a copy of what the producer gave to the insured since premium is not binding upon the insured until such notification is provided. Therefore all 50 files failed this test.

*Results:* Failed (error rate 100%)

*Recommendations:* It is recommended that the broker create written procedures to maintain a copy of the required notification to the insured about the surplus lines insurance company as required by statute. As the broker does not contact the insured directly, they should include in their files a copy of the required notification from the producer to the insured.

12. Confirm coverage is placed with an eligible non-admitted insurer

AS 21.34.050

*Comments:* All policies in the audit were placed with eligible companies.

*Results:* Passed (error rate 0%)

13. Review notice regarding nonrenewal and premium increase

3 AAC 25.050

*Comments:* The broker primarily uses three surplus lines insurance companies: Penn-Star, Northfield, and Nautilus. Penn-Star includes the Alaska policyholder notice when they prepare the policies. Northfield and Nautilus are prepared by the broker. Nautilus has a supplemental documents list on which the broker types in the Alaska policyholder notice as being attached to the policy. Northfield does not have any type of document list so there is no notation in the file that the notice was attached to the policy. It is procedure to attach it to every surplus lines policy that goes out and staff spot check the policies periodically before mailing but since they don't maintain copies of the policies in the electronic file, there is no way for anyone else looking at the electronic file to know the insured received the notice as part of the policy. The broker does not maintain an entire copy of each policy as many pages are redundant so they just list them.

Twenty-one files did not have any indication the required Alaska policyholder notice of nonrenewal and premium increase was included in the policy.

*Results:* Failed (29 files passed & 21 failed, error rate 42%)

*Recommendation:* It is recommended that the broker create written procedures to include the requirement of notating what documents are attached to the policies. The dec page for Northfield Insurance Company already contains other notations for documents so this is the most logical place to include the Alaska Policyholder Notice, as staff determined while the tax auditor was in the office.

*The Insurance Center response received April 10, 2008:* We will be more diligent in documenting our file that the nonrenewal and premium increase notice is being sent on every binder/policy and for every term of coverage.

## **File Documentation**

*Comments:* While reviewing the electronic files, there were two issues of concern noticed:

1. One file included a document that belongs to another insured, which could lead to inadvertent disclosure of confidential information if a piece of information was provided to the wrong person.
2. When preparing documents such as certificates and terrorism disclosure sometimes the admitted company name that is part of the same group as the surplus lines company shows as the insurance carrier for the coverage instead of the surplus lines carrier.

*Recommendation:* It is recommended that the broker be more diligent in their efforts regarding the creation of the surplus lines documents to list the correct company the policy is written with. As an example of the importance of having the correct insurance company, certificate holders care who the insurer is and their status in Alaska. Some certificate holders require an admitted company and coverage with a surplus lines company would not meet their requirements. Staff needs to be more diligent in not scanning in documents to wrong files. Staff needs to delete the incorrect insured document from the file found during the audit. Since writing in the surplus lines market is a small part of the broker's business, extra care should be taken when handling a surplus lines transaction.

All surplus lines transaction files for both years and up to current should be reviewed and any page showing the wrong insurance company needs to be reprinted for the insured. It is very important for the policies and certificates to be accurate in the hands of the insured.

*The Insurance Center response received April 10, 2008:* We will endeavor to correct this immediately.

## **SUMMARY AND SUBSEQUENT EVENTS**

### **Summary**

This was a premium tax audit of The Insurance Center. The auditor tested 13 standards focusing on the broker's filing of monthly and annual tax reports and the subsequent payment of premium taxes and filing fees as well as due diligence and notification requirements for using a non-admitted insurer.

The compliance officer and staff were cooperative during the audit. The tax auditor appreciated this attitude and enjoyed working with The Insurance Center's management and staff.

Several significant issues did arise during the audit.

- 1) The misstatement of insurance companies throughout the documents in a file is a major concern.

- 2) The required notification to the insured regarding the use of a nonadmitted insurer was not found in any file
- 3) Notifications on the electronic documents in the files were not followed through when the required stamps were used on the hard copy of policies. In addition, the stamps used do not meet statute requirements.
- 4) The diligent search in the admitted market first was not documented in many of the files or if it was, some were received after binding.

### **Re-Audit**

In closing, while the auditor found problems with the reports and payments, she also found that the broker wants to do things right. This was evident when in the response to the missing documentation of the nonrenewal and premium increase notice; staff immediately put into practice a new procedure to include the notice on the dec page where other documents are listed. The auditor's recommended actions, including those already implemented by the broker, should correct the problems encountered and it is recommended that The Insurance Center be re-audited within the next three years to ascertain compliance with them.


Submitted by:  
Rebecca Nesheim  
Tax Auditor

Affidavit

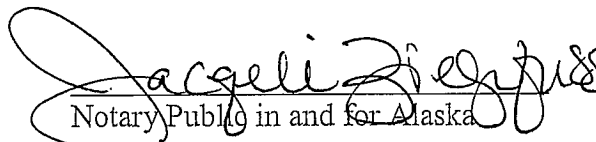
The Insurance Center  
As of December 31, 2007  
TA 08-01

Juneau, Alaska            )  
August 11, 2008         )  
                                  )  
State of Alaska         ) ss.  
First Judicial District )

I, being duly sworn, do verify that the report of premium tax audit as of December 31, 2007 of The Insurance Center is true to the best of my knowledge and belief.

  
\_\_\_\_\_  
Rebecca Nesheim  
Tax Auditor

SUBSCRIBED and SWORN to before me this 11 day of August, 2008

  
\_\_\_\_\_  
Notary Public in and for Alaska  
My Commission Expires with office