

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

Order # TA 09-01)
In the Matter of Audit of)
American E & S Insurance Brokers California Inc)
_____)

FINDINGS OF FACT

1. An audit report of American E & S Insurance Brokers California Inc, licensed in the State of Alaska, has been issued by the State of Alaska, Division of Insurance to American E & S Insurance Brokers California Inc.
2. The audit report of American E & S Insurance Brokers California Inc (TA 09-01) has been transmitted to Stanley Chris King, Compliance Officer, American E & S Insurance Brokers California Inc (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

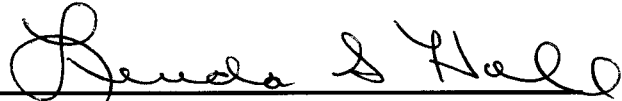
IT IS ORDERED

1. Pursuant to AS 21.06.150(b)(1), the audit report of American E & S Insurance Brokers California Inc (TA 09-01) 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 September 3, 2009.

Dated this 3rd day of September, 2009 at Juneau, Alaska.

A handwritten signature in black ink, appearing to read "Linda S. Hall", written over a horizontal line.

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

PREMIUM TAX AUDIT OF

**American E & S Insurance Brokers California Inc
Seattle, WA**

TA 09-01

As of December 31, 2008

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



**FINAL REPORT:
September 3, 2009**

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DEPARTMENT OF
COMMERCE
COMMUNITY AND
ECONOMIC DEVELOPMENT

Division of Insurance

Sean Parnell, Governor
Emil Notti, Commissioner
Linda S. Hall, Director

September 3, 2009

Linda S. Hall, CPCU
Director, Division of Insurance
Department of Commerce, Community and Economic Development
550 West 7th 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 American E & S Insurance Brokers California Inc (the broker) on March 23, 2009 through March 27, 2009, in the broker's Seattle, WA office. The audit was conducted by Rebecca Nesheim, tax auditor for the Alaska Division of Insurance.

American E & S Insurance Brokers California Inc

SCOPE OF AUDIT

This premium tax audit was called to review compliance with the surplus lines statutes AS 21.34, and regulations 3 AAC 25 and the premium tax regulations 3 AAC 21.550 – 570. This is the first premium tax audit of the broker conducted by the Alaska Division of Insurance.

Subject Matters Audited

The broker is an Alaska licensed surplus lines broker based in Seattle, WA. The division selected 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, 2007 through December 31, 2008.

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METHODOLOGY

The tax auditor sent the call letter and initial data requests to the broker's office in Seattle, WA. A list of all Alaska business transactions with non-admitted insurers was requested for the period to be audited. The broker complied on a timely basis with all data requests. The number of policies and endorsements written during the audit period was 501, from which a sample of 50 files was selected for audit.

The following are the procedures steps for the audit:

- 1) Verify that monthly premium reports and accompanying forms were filed on time.
 - 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) Verified the multi-state allocation form was filed when appropriate.
- 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 on time.
 - 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.
- 7) Verify if tax and filing fee payments were made on time 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 monthly 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
 - 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
- 11) 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
- 12) 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 or other evidence of insurance.

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 on time
AS 21.34.080 and .170, 3 AAC 25.090 and .100

Comments: All 24 monthly reports for the audit period were filed on time.

Result: Passed (error rate 0%)

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 25.090 and .100

Comments: The surplus lines broker who writes the business fills out the transaction form and gives it to the broker who prepares the monthly reports. Each month an administrative staff member prepares a list from the invoicing system that the broker uses to compare against the transactions to ensure all are captured. The broker then fills out the monthly report and sends in to the Division.

One policy effective in July 2008 was not included in the original monthly report when filed. It was sent as an amended transaction in September 2008 to the monthly filing and was assessed a penalty, paid prior to the audit. This affects two additional tests: accuracy of the tax reports and payments.

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

Recommendations: It is recommended that the broker follow their written procedures for when to report initial or renewal policies as well as endorsements to the Alaska Division of Insurance. 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.

Response by broker: We had one policy which was effective in July 2008 which was not included in the original monthly report when filed. The broker handling the account failed to get it invoiced in a timely manner. It was sent as an amended transaction in September 2008 to the monthly filing and was assessed a penalty, paid prior to the audit. All employees have been reminded that filings must be made within 30 days. An email reminder is sent to all employees before the monthly report has been prepared. Additionally, in this situation, the completed transaction report was with the policy and inadvertently placed underneath correspondence regarding an ongoing accounting problem (cancellation for non-payment and subsequent reinstatement) so the transaction report did not get placed with the pending filings. The accuracy of the accounting report has greatly improved since July 2008. This serves as a back-up to the transaction reports that are placed in a central location pending the monthly report. Transactions that have been mistakenly placed with the policy folder without being filed will be identified by this accounting report.

4. Verify the multi-state placements are filed correctly

AS 21.34.180

Comments: There was one multi-state policy in the audited files. The premium allocation was reasonable based on statute requirements.

Result: Passed (error rate 0%)

5. Verify quarterly and annual premium tax reports were filed on time

AS 21.34.180, 3 AAC 21

Comments: The eight premium tax reports were filed on time.

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 2008 2nd quarter tax report was not accurate because it was sent to the Division before a late transaction for the quarter was reported. The inaccuracy of the monthly reports due to the late transaction affects this test, which in turn affects the accuracy of the payment.

Result: Passed (error rate 0%)

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

AS 21.34.180, 3 AAC 21

Comments: There was one payment made late during 2008. The late transaction on the monthly report was filed before the 2nd quarter due date but the tax for the transaction was not paid on time. The late penalty was assessed and paid prior to the audit.

Results: Failed (7 payments passed, 1 failed, error rate 13%)

Recommendation: It is recommended that the broker follow their procedures and make all payments on time as required by statutory deadlines. Procedures should be revised to account for amended transactions that require a payment as of the next due date.

Response by broker: We had one late payment during 2008. A late payment penalty was assessed and paid prior to the audit. In this situation, a revised monthly filing was overlooked when the annual summary was prepared. Since that time, copies of all internally prepared monthly summaries, including any revised summaries, are kept electronically and in a hard copy folder pending the annual payment. As a back-up procedure, an Excel summary is also prepared showing monthly premium totals as well as quarterly payments.

8. Verify tax and filing fees payments were made accurately

AS 21.34.180, 3 AAC 21

Comments: All payments were made correctly as required by the tax reports as filed. However, since the monthly reports were not accurate, the 2nd quarter 2008 tax report was not accurate, thus the payment was not accurate. This was corrected prior to the audit. All payments were made by ACH as required.

Results: Passed (error rate 0%)

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

AS 21.34.020, 3 AAC 25.030 and .035

Comments: Three policy files do not have the required diligent search documented prior to binding. The broker uses the affidavit of due diligence (DD) form and in most circumstances will not bind until they receive the DD, as evidenced in their email requests to producers. However, there were three DD's received after binding with no documentation in the file of the inability to place in the admitted market.

Results: Passed (47 files passed & 3 failed, error rate 6%)

Recommendations: It is recommended the broker follow their procedures and not make a placement in the surplus lines market until they have documented the diligent search of the admitted market. The requirement is that the broker must have documentation prior to binding, not prior to the effective date of the policy.

Response by broker: We are instructing our employees that the completed Affidavit of Due Diligence is required prior to binding and should be carefully reviewed for completion and accuracy. Additionally, we should review the Surplus Lines Placement List and document our file concerning the risk falling into a class of business unavailable from the admitted insurers.

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

AS 21.34.100(e)

Comments: Five policy files included evidence of insurance that did not have the stamp required by AS 21.34.100(e). Three were premium bearing endorsements, one a binder and one both a binder and the confirmation of coverage. In one additional file, the dec page included the required stamp but it was illegible and therefore does not meet the notification requirement.

Results: Failed (44 files passed & 6 failed, error rate 12%)

Recommendations: It is recommended that the broker revise their procedures to include stamping all endorsements, both premium and non-premium bearing. The stamp used by the broker is considerably larger than required by statute. It may be beneficial to purchase new stamps using a smaller font in order for the stamp to fit better on the evidence of insurance.

Response by broker: We had several items which were not stamped per AS 21.34.100(e). Three were premium bearing endorsements, one a binder and one both a binder and the confirmation of coverage. We will instruct our employees that all policies, endorsements (premium and non-premium bearing), cover notes, binders, evidences of insurance or confirmations of coverage placed be stamped clearly so that the required stamp is legible. I would like to add that there were some items reviewed, such as the State of Alaska property account, in which the S.L. filings were made by the retail producer. Our documents would not have been stamped in such a case where AES was not doing the filings. Our binder or confirmation of coverage stated clearly that the retail producer was responsible for the filings.

11. Review notification for use of non-admitted insurer

AS 21.34.110

Comments: Three policy files did not contain the required 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 business practice of the broker to provide the notification to the insured but copies of the documentation was missed in three files.

Results: Passed (47 files passed & 3 failed, error rate 6%)

Recommendations: It is recommended that the broker continue to follow their procedures and provide the required notification prior to invoicing the insured. It is for the insured's protection that they are fully informed and a copy is maintained in the file.

Response by broker: Three files were noted which did not contain the required notification per AS 21.34.110. We are reiterating to our employees that the Alaska Notice should be used on all quotes and binders involving non-admitted insurers.

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: All files in the audit included the required notification; however four files contained an outdated notice referencing incorrect statute cites. Although this notice is the insurance company's responsibility to attach to the policy, the broker has the responsibility to ensure the correct notice is part of the policy.

Results: Passed (error rate 0%)

Recommendations: It is recommended that the broker revise their written procedures to include a step in the policy review to ensure the correct required notification is attached to the policy. They need to contact the insurance company when the notice is outdated.

Response by broker: We had four files containing an outdated notice referencing incorrect statutes. We are now aware of the situation, including the latest change per Bulletin B 08-06. We are instructing our employees to check this document (Alaska Policyholder Notice) when reviewing insurance policies. Any outdated forms will be pointed out to the carrier with a copy of the latest Bulletin applicable.

File Documentation

Comments: One file was missing a confirmation of coverage that was mentioned as attached in an email to the producer.

Recommendations: It is recommended that the broker follow their procedures for maintaining a copy of all documentation required in statute.

Response by broker: We had one file missing a confirmation of coverage that was mentioned as attached in an email to the producer. We are instructing our employees that full documentation must be maintained in the policy file. Even if a document is scanned and sent as an attachment to an email, we must keep a copy in the file. Additionally, we have updated our Policy Checklist with emphasis upon a review of Alaska requirements at the time an account is quoted or bound, rather than after the policy is received.

SUMMARY AND SUBSEQUENT EVENTS

Summary

This was a premium tax audit of American E & S Insurance Brokers California Inc. 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 broker's management and staff.

Several significant issues did arise during the audit.

- 1) The required notification to the insured regarding the use of a non-admitted insurer was not found in three files
- 2) The required disclosure on the evidence of insurance was not found on any premium or non-premium bearing endorsement.
- 3) The record of a diligent search of the admitted market was received after binding for several files.

Re-Audit

In closing, the auditor's recommended actions should help the broker correct the problems encountered. It is recommended that American E & S Insurance Brokers California Inc be re-audited within the next five years to ascertain compliance.

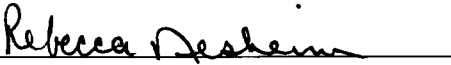
Submitted by:
Rebecca Nesheim
Tax Auditor

Affidavit

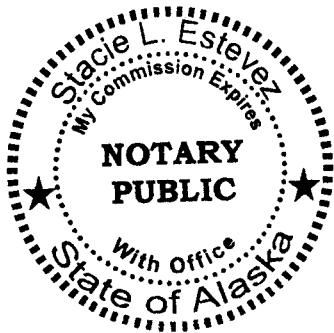
American E & S Insurance Brokers California Inc
As of December 31, 2008
TA 09-01

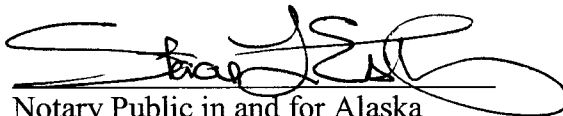
Juneau, Alaska)
September 3, 2009)
State of Alaska) ss.
First Judicial District)

I, being duly sworn, do verify that the report of premium tax audit as of December 31, 2008 of American E & S Insurance Brokers California Inc is true to the best of my knowledge and belief.


Rebecca Nesheim
Tax Auditor

SUBSCRIBED and SWORN to before me this 9th day of September, 2009




Notary Public in and for Alaska

My Commission Expires with office