

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 10-01 )  
In the Matter of Audit of )  
Alaska USA Insurance Brokers LLC )  
\_\_\_\_\_ )

FINDINGS OF FACT

1. An audit report of Alaska USA Insurance Brokers LLC, licensed in the state of Alaska, has been issued by the State of Alaska, Division of Insurance to Alaska USA Insurance Brokers LLC.

2. The audit report of Alaska USA Insurance Brokers LLC (TA 10-01) has been transmitted to David A Kester, Compliance Officer, Alaska USA Insurance Brokers LLC (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

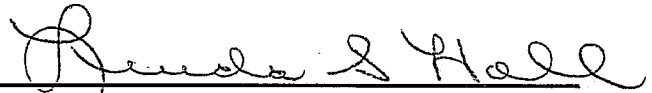
IT IS ORDERED

1. Pursuant to AS 21.06.150(b)(1), the audit report of Alaska USA Insurance Brokers LLC (TA 10-01) 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 JAN 18, 2011.

Dated this 18<sup>th</sup> day of JANUARY, 2011 at Anchorage, Alaska.



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

**PREMIUM TAX AUDIT OF**

**Alaska USA Insurance Brokers LLC  
Anchorage, AK**

**TA 10-01**

**As of December 31, 2009**

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



**FINAL REPORT:  
January 10, 2011**

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DEPARTMENT OF  
**COMMERCE**  
COMMUNITY AND  
ECONOMIC DEVELOPMENT

Division of Insurance

*Sean Parnell, Governor*  
*Susan K. Bell, Commissioner*  
*Linda S. Hall, Director*

January 10, 2011

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 Alaska USA Insurance Brokers LLC (the broker) on April 26, 2010 through April 30, 2010, in the broker's Anchorage, AK office. The audit was conducted by Rebecca Nesheim, tax auditor for the Alaska Division of Insurance.

**Alaska USA Insurance Brokers LLC**

**SCOPE OF AUDIT**

This premium tax audit was called to review compliance with the surplus lines statutes AS 21.34, limited AS 21.27, regulations 3 AAC 25 and the premium tax regulations 3 AAC 21.550 – 570. This is the first premium tax audit of Alaska USA Insurance Brokers LLC conducted by the Alaska Division of Insurance (the Division).

**Subject Matters Audited**

Alaska USA Insurance Brokers LLC 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, 2008 through December 31, 2009.

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## METHODOLOGY

The tax auditor sent the call letter and initial data requests to the broker's office in Anchorage, AK. A list of all Alaska business transactions with non-admitted insurers was requested for the period to be audited. The broker complied in a timely manner with all data requests. A list was received from the broker of the non-admitted transactions for the audit period. Fifty files were pulled to audit. Two files were deleted from the initial list drawn due to them being written with an admitted company and one was a duplicate transaction. Two additional files were drawn from the initial list to include in audit. Once on site, one of the additional two drawn was also determined to be admitted and two others on the initial sample drawn were admitted but were coded incorrectly as surplus lines, which is how they ended up on the initial list. Three more in the initial list were non-admitted but another surplus lines broker reported them to the Division. So, six more were selected from the complete list. Turns out one of the six was also filed by another broker. However, two more of them were actually written with an admitted carrier so now down to 47 files and will use only those for the 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 Division 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. The invoice date determines 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, invoice date, premiums, taxes and fees based upon the information in the files.
    - (4) Verified the multi-state allocation form or similar documentation 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 Division.
- 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 Division 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 documentation of diligent search was received prior to binding. 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 evidence of insurance to ensure the broker's name and stamp required by statute AS 21.34.100(e) is present and legible.
- 11) Review notifications 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
- 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 and 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

- |   |
|---|
| <b>1. Verify that monthly premium reports and accompanying forms were filed on time</b><br><b style="text-align: right;">AS 21.34.080 and .170, 3 AAC 25.090 and .100</b> |
|---|

*Comments:* All 24 monthly reports were filed on time.

*Result:* Passed (error rate 0%)

- |  |
|--|
| <b>2. Verify the accuracy of the premium calculation</b><br><b style="text-align: right;">AS 21.34.180</b> |
|--|

*Comments:* One policy transaction filed with the Division reduced the original premium by an endorsement amount they were expecting. However, when the endorsement came in they also filed that; thus, the endorsement return premium was filed twice. The tax and filing fee amounts for the duplicate return premium was negligible. Another policy charged the tax and fees on the broker fee to the insured but filed correctly with the Division. The insured should receive a refund for the tax and fees paid on the broker fee.

This error affects three other tests: accuracy of the monthly report, tax report and tax & fee payment.

*Result:* Passed (45 files passed & 2 failed, error rate 4.3%)

*Recommendations:* It is recommended that the broker file each transaction separately instead of combining them into one document so as not to duplicate transactions. The broker should also ensure their written procedures are followed to ensure broker fees are not part of the tax and filing fee calculation for either the insured or the Division.

*Broker's response:* Corrected both items that were found. When possible premiums are broken out however sometimes the carrier will endorse a policy rather than include the change in the renewal premium and visa versa. With the implementation of ImageRight we are better able to view the transactions as they happen and therefore corrections can be made as necessary.

With regards to the brokers fee not being included for purposes of premium computation, we feel this has been addressed in several ways:

- a) Procedures outline charges going to the carrier (premium) are included while charges going to the MGA are not included
- b) Set up a separate billing code for Policy Fee (premium to the company) vs. Broker Fee (fee to the MGA)
- c) Classes – training is held with each new employee according to their job duties, within 90 days.
- d) This class is being added to appropriate employees transcripts as required training to be taken every 2 years from initial training session.
- e) ImageRight allows us to see all transactions, so error made in calculations can be addressed and corrected.



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

**AS 21.34.080 and .170, 3 AAC 25.090 and .100**

*Comments:* Three policy transactions were filed incorrectly with the Division. Two policy transactions were filed with incorrect premiums initially. They were corrected prior to the audit. One policy had an endorsement that was filed late.

These errors affect two other tests: accuracy of the tax reports and tax & fee payments

*Result:* Passed (44 files passed & 3 failed, error rate 6.4%)

*Recommendations:* It is recommended that the broker revise their written procedures to include the due dates for when initial or renewal policies as well as endorsements are to be reported to the Division. Alaska regulations have the required due dates for transactions. Following the written procedures will ensure all transactions are filed in the correct month. Quality control on the information entered into the computer systems should be enhanced in order to retain more control over those transactions not coded correctly or not invoiced as expected that cause certain policies to not appear on reports used to create the monthly reports.

*Broker's response:* We have incorporated changes to identify specific dates that forms are due to the compliance officer so they may file reports in a timely manner. With the implementation of ImageRight, this provides us better quality control to determine if items are billed correctly and timely.

**4. Verify the multi-state placements are filed correctly**

**AS 21.34.180**

*Comments:* There were four insured's that had some none-Alaska locations but for each of the policies in the audit, no exposure was attributed to those locations. Therefore all policies were filed as 100% Alaska risk as appropriate.

*Result:* Passed (error rate 0%)

*Recommendations:* It is recommended that the broker revise their written procedures for multi-state transactions to include how to identify when a risk is located in multiple states, what additional documents must be included in state filings, and how to allocate premium.

*Broker's response:* We have incorporated the handling of multi-state policies into our procedures manual, whereby we will only work with Surplus Lines Brokers that can file taxes and fees outside of Alaska.

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

AS 21.34.180, 3 AAC 21

*Comments:* Two quarterly premium tax reports were filed late: 1st & 3rd quarter 2009. All remaining tax reports for the two years were filed on time.

*Result:* Failed (6 reports passed, 2 failed, error rate 25%)

*Recommendations:* It is recommended that the broker follow their written procedures by filing tax reports on or before their due date. Postmarks are accepted documentation the report was filed on time.

*Broker's response:* Currently we have one individual responsible for filing the quarterly tax reports. We have also added a backup person for this responsibility as well as set a date 5 days prior to the due date to avoid late reporting.

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

AS 21.34.180, 3 AAC 21

*Comments:* The tax reports were accurate based upon the monthly reports filed. Several audit errors resulted in the tax reports actually not being accurate and these errors were accounted for in their respective audit tests.

*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:* The first quarter 2009 tax payment was made late for which a penalty was assessed and paid prior to the audit. The 2009 annual premium tax and filing fees were paid by check instead of by ACH as required for which a penalty was assessed and paid prior to the audit. All remaining payments for the two years were made on time and by ACH.

*Results:* Failed (6 payments passed, 2 failed, error rate 25%)

*Recommendations:* It is recommended that the broker revise their written procedures to include due dates for all payments to ensure they are made on time. Instructions for making payments via ACH would also be beneficial in the procedures. It would be in the best interest of the broker to make payments several days in advance so that if an amount is incorrect or there are problems with a particular ACH payment, another payment could still be made by the due date.

*Broker's response:* We have incorporated in our procedures the time line for when payments are due and when the payment from our office will be made.

**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. Several audit errors resulted in the tax payments actually not being accurate and these errors were accounted for in their respective audit tests.

*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:* The broker has chosen to use the Affidavit of Due Diligence to document the admitted market diligent search. Two affidavits were not received or created prior to binding and one affidavit was missing from the insured's electronic file. There was a notation in AMS that it was generated (after binding) but nothing was in the file.

*Results:* Passed (44 files passed & 3 failed, error rate 6.4%)

*Recommendations:* It is recommended that the broker revise their written procedures to ensure all Affidavits of Due Diligence are received or created prior to binding. The current procedures state: Upon binding (done the day request is made) complete the Affidavit of Due Diligence.

*Broker's response:* We have amended our current procedures to clarify when the affidavit is due. "This must be created prior to binding coverage including those risks on the Placement List. The affidavit must be sent to the Surplus Lines Broker upon binding or prior to the effective date."

*Division response:* The new procedures need to be clearer, that the affidavit must be *provided* to the broker *prior to binding*. The effective date is not relevant per Alaska statutes and regulations relating to the diligent search documentation efforts.

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

**AS 21.34.100(e)**

*Comments:* The current procedure is the broker stamps the binder at the time of binding and the policy is stamped at the time it is ready to send to the client. However, thirty-one files had either no disclosure stamp or there was no name on the evidence of insurance:

- No stamp on policy dec - 8
- No stamp on binder - 4
- No stamp on confirmation of coverage - 3
- No stamp on multiple evidence of insurance - 7
- No stamp on endorsements - 3
- No name on policy dec - 12
- No name on multiple evidence of insurance - 2
- Wrong stamp (WA instead of AK) - 1

Total disclosure errors: 40 within 31 distinct files

Seven insured's files had at least one evidence of insurance unavailable during the audit so this test could not be performed on those documents. One of the files had no evidence of insurance.

*Results:* Failed (15 files passed & 31 failed, error rate 67.4%)

*Recommendations:* It is recommended that the broker ensure the written procedures are followed for stamping the evidence of insurance as the procedures are well documented. The binder checklist should be revised to include the stamp requirement when the transaction is surplus lines. It is also recommended to create a new disclosure stamp that includes the broker's name along with the required language per statute.

*Broker's response:* With the implementation of ImageRight we have in place a Surplus Lines workflow to ensure that the evidence of insurance is stamped and are adding an additional task step to make sure the Original document is stamped. The binder checklist has been updated to include the stamping requirement. A disclosure stamp with the AK Statute, our agency name & license # is already being used and is only available to the Surplus Lines agents. Not sure why one policy would have had a WA stamp, as we do not possess a WA stamp, it must have come in from the MGA/Carrier that way.

<b>11. Review notification for use of non-admitted insurer</b>
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<b>AS 21.34.110</b>
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*Comments:* The broker generally provides the required notification per statute in a Surplus Lines Placement Combined Notice sent as part of the proposal to the insured. However, five of the audit files showed no information was provided to the insured. Four files did not have a copy of the proposal and one file had a copy of the proposal but the Notice was not included. Several Notices included inaccurate information relating to the policy dates for the insured such as stating premium is due and payable by 1/27/2005 for a 2008-2009 policy term.

*Results:* Failed (42 files passed & 5 failed, error rate 10.6%)

*Recommendations:* It is recommended that the broker ensure the written procedures are followed to include the Notice as part of the proposal and to maintain a copy of the notification in the insured's file as required by statute. Quality control procedures should be set up to ensure the correct information is on documents.

*Broker's response:* ImageRight allows better control to ensure the Notice of Surplus Lines Placement is being done. We have updated the form letter within our system to properly fill the effective date of the policy. We have readdressed the importance of having this form completed and included with our proposals and if no proposal is done it is to be sent to the insured with their renewal letter prior to the effective date of the policy.

**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:* Sixteen files did not have evidence of the required notice of nonrenewal and premium increase being sent to the insured as part of the evidence of insurance. Six policies included the notice but it was not the most current approved by the director.

Five insured's policies were unavailable during the audit so this test was not performed on those documents.

*Results:* Failed (26 files passed & 16 failed, error rate 38%)

*Recommendations:* It is recommended that the broker revise their written procedures to include a step in the processing of evidence of insurance to ensure the notice is included from the insurance company. Consider adding this step to the policy and binder check-in checklists.

*Broker's response:* Regulation 3 AAC 25.050 states "An eligible surplus lines insurer shall include in each policy, binder and cover note an Alaska surplus lines policyholder notice regarding nonrenewal and premium increase, in a format approved by the director." As a service to our insured we have incorporated into our Policy checklist to see that this form is included.

*Division response:* It is the licensed surplus lines broker who has the responsibility of ensuring that their records include the terms of the contract and thus ensure that a surplus lines policy is complete and accurate.

**File Documentation:**

*Comments:* During a portion of the two years under audit, the broker filed paper documents by date processed prior to instituting imaging documents into the insured's electronic file. The broker was unable to locate the paper version of evidence of insurance for seven insured's as required to be maintained per Alaska Statute 21.27.350, which resulted in several of the audit tests impossible to complete, the disclosure stamp requirements and the Alaska Policyholder Notice:

1. Four policies were not available
2. Two binders were not available
3. One insured's policy and binder were not available

When the broker gets the producer copy from the company (or MGA) often times it is not the complete policy but just the dec page and a few other pieces of the policy. The insured copy has

every form attached. The broker does not make a copy of the insured policy in order to maintain a full copy as they do not have the manpower to do the copying. However, they also do not scan the insured's copy into the electronic file either. They feel that since the dec has listed the policy pages and they can get copies of them from the company if they need them, that it isn't necessary to maintain a copy.

*Recommendation:* It is recommended that the broker ensure the insured's electronic file includes all documents related to an insurance policy. This includes a complete copy of the policy, binder, and other evidence of insurance and information about the transaction as required by statute. By scanning the insured's copy of the evidence of insurance, it will be clear what stamps and notices were part of the copy provided to the insured.

*Broker's response:* The statute reads as follows:

Sec. 21.27.350. Records of licensees.

(b) A licensee shall keep at the licensee's place of business or **at the place of business of an admitted insurer** a complete record of transactions under the license. An admitted insurer shall maintain records received from a licensee as required by this section.

Are we to assume that because it is clear that this references "admitted insurer" that the licensee for "non-admitted" are required to keep a full copy of a policy? Since the insurer maintains a complete record of transactions (policy) at their place of business and only provides us a limited copy (Brokers copy) we feel we are in compliance with the statute stated above.

With regards to missing policies & binders we have procedures in place to avoid misfiling. We have addressed this issue and have taken additional steps to eliminate future occurrences of misfilings.

*Division response:* The section cited (AS 21.27.350 (b)) references the responsibility of the licensee to keep records either at their own place of business or at the place of business of an admitted insurer. It deals with the location of the records, not the content of those records. AS 21.27.350 (a) requires that licensees "...document each action taken in regard to an insurance transaction ...the documentation must contain all notes, work papers, documents, and similar material... and must include a record of each insurance contract procured..." The broker receives a complete copy for the insured and this policy should be scanned into ImageRight to be maintained after all stamping requirements are completed.

## SUMMARY AND SUBSEQUENT EVENTS

### Summary

This was a premium tax audit of Alaska USA Insurance Brokers LLC. 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 Alaska USA Insurance Brokers LLC's management and staff.

Several significant issues did arise during the audit that affects the service to the insured and compliance with Alaska statutes and regulations.

- 1) Several tax reports and payments were not received on time resulting in monetary penalties.
- 2) The disclosure requirements of stamping evidence of insurance including the broker's name were missing from more than half the audit files.
- 3) The required notification to the insured regarding the use of a non-admitted insurer was not found in several files
- 4) The Alaska Policyholder Notice for nonrenewal and premium increase was not found in many of the files.
- 5) Documentation required to be maintained regarding the policy transactions were not available to review for several files.

### Re-Audit

In closing, the auditor's recommended actions should help the broker correct the problems encountered. It is recommended that Alaska USA Insurance Brokers LLC be re-audited within the next three years to ascertain compliance.

Submitted by:  
Rebecca Nesheim  
Tax Auditor

Affidavit

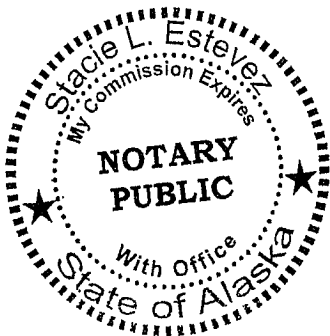
Alaska USA Insurance Brokers LLC  
As of December 31, 2009  
TA 10-01

Juneau, Alaska            )  
October 25, 2010        )  
                                  )  
State of Alaska         ) ss.  
First Judicial District )

I, being duly sworn, do verify that the report of premium tax audit as of December 31, 2009 of Alaska USA Insurance Brokers LLC is true to the best of my knowledge and belief.

Rebecca Nesheim  
Rebecca Nesheim  
Tax Auditor

SUBSCRIBED and SWORN to before me this 25<sup>th</sup> day of October, 2010



Stacie Estevez  
Notary Public in and for Alaska

My Commission Expires with office