

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 12-05)
In the Matter of Audit of)
R T Specialty LLC)
_____)

FINDINGS OF FACT

1. An audit report of R T Specialty LLC, licensed in the State of Alaska, has been issued by the State of Alaska, Division of Insurance to R T Specialty LLC.
2. The audit report of R T Specialty LLC (TA 12-05) has been transmitted to Frank L Phillips, Compliance Officer, R T Specialty 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 he 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 he 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 R T Specialty LLC (TA 12-05) 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 January 8, 2013.

Dated this 8th day of January, 2013 at Anchorage, Alaska.



Bret S. Kolb, Director
State of Alaska
Division of Insurance

PREMIUM TAX AUDIT OF

R T Specialty LLC

Audit Location: Seattle, WA

Headquarters: Chicago, IL

Alaska License # 85645

TA 12-05

As of December 31, 2011

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



**FINAL REPORT:
January 8, 2013**

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THE STATE
of **ALASKA**
GOVERNOR SEAN PARNELL

Department of Commerce, Community,
and Economic Development

DIVISION OF INSURANCE
Juneau Office

P.O. Box 110805
Juneau, Alaska 99811-0805
Main: 907.465.2515
Fax: 907.465.3422
TDD: 907.465.5437

January 8, 2013

Bret S. Kolb
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 R T Specialty LLC (the broker) on September 24, 2012 through September 28, 2012, in the broker's Seattle, WA office. The audit was conducted by Rebecca Nesheim, tax auditor for the Alaska Division of Insurance.

R T Specialty LLC

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 R T Specialty LLC conducted by the Alaska Division of Insurance.

Subject Matters Audited

R T Specialty LLC is an Alaska licensed surplus lines broker headquartered in Chicago, IL with branch offices all over the United States. The broker received their Alaska license in 2010. They are in the process of acquiring a number of other agencies some that do a fair share of business for Alaskan insureds. The majority of Alaska business is written out of the Seattle, WA office where most of the files were located so the audit was conducted in Seattle. The Division elected to audit their financial filings, premium taxes 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 year January 1, 2010 through December 31, 2011.

METHODOLOGY

The tax auditor sent the call letter and initial data requests to the broker's office in Chicago, IL. The surplus lines coordinator from Denver, CO met the auditor in the broker's Seattle office to conduct the audit as most of the files were located in Seattle. Several files had to be mailed in from other branch offices for the audit. A list of all Alaska business transactions with nonadmitted insurers was requested for the period to be audited. The broker complied on a timely basis with all data requests. The number of policies written during the audit period was 186, from which a sample of 50 files was selected for audit.

The following are the procedures steps for the audit:

- 1) Verify that monthly reports, quarterly reports, and accompanying forms were filed on time.
 - i) Audit steps taken:
 - (1) Reviewed the monthly and quarterly files sent to the Alaska Division of Insurance and verified the reports were filed by the due date.
- 2) Verify the accuracy of the premium calculation
 - i) Audit steps taken:
 - (1) Reviewed policy, declaration page, and invoices to determine how taxable premium was calculated.
 - (2) Verified the correct premium was reported on the reports as filed.
- 3) Verify the accuracy of all monthly and quarterly reports filed.
 - i) Audit steps taken:
 - (1) Reviewed the policy, declaration, and endorsement pages in each file.
 - (2) If the effective date did not match the monthly or quarterly 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 determines in which month or quarter the endorsement is required to be filed.
 - (3) Verified the monthly and quarterly 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 a statement of exempt premiums was filed when appropriate.
 - (5) Verified the policy was included in the monthly or quarterly filing based upon the effective date of the policy.
- 4) If the placement is a multi-state placement, check the calculation and reasonableness of the methodology used to allocate.
 - i) Audit steps taken:
 - (1) Verified the allocation of premium for each state is reasonable and the calculation is accurate.
 - (2) Verified the multi-state allocation form was filed when appropriate
- 5) Verify quarterly tax and annual premium tax reports were filed on time.
 - i) Audit steps taken:
 - (1) Confirmed when the quarterly tax and annual premium tax reports were sent to the Alaska Division of Insurance.

- 6) Verify the accuracy of the quarterly tax and annual premium tax reports
 - i) Audit steps taken:
 - (1) Verified the quarterly tax 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 received by 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 the diligent search was documented prior to binding and the declinations completed. If no declinations due to risk on 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 an Alaska Policyholder Notice regarding nonrenewal and premium increase included with the policy, binder or cover note.

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 reports, quarterly reports and accompanying forms were filed on time
AS 21.34.080 and .170, 3 AAC 25.090 and .100

Comments: The broker was responsible for potentially filing 22 monthly or quarterly reports from the point they received their Alaska license for the audit period. Six monthly reports were not required to be filed as no business was written. Seven monthly reports were filed after the due date and penalties were assessed prior to the audit. The two 2011 quarterly reports were filed on time.

Results: Failed (15 reports passed & 7 failed, error rate 32%)

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

Broker response: During the course of an internal review, RTS discovered irregularities in certain surplus lines tax filings. To address these deficiencies, RTS began remedial action, including: (1) the removal and/or reassignment of managers and employees involved filing surplus lines tax filings, (2) the creation of a separate compliance initiative to address the deficiencies and to provide remedial training, (3) the institution of a more robust compliance plan/internal audit program, (4) increased headcount in the surplus lines tax department to accommodate the growing number of transactions generated by RTS taking into consideration its rapid growth and acquisitions, and (5) an in-depth study conducted by a committee appointed by the board of directors to review the effectiveness of the existing agency management system.

As part of the remedial actions taken, a reconciliation of surplus lines taxes was performed, which included Alaska. As referenced in the report, revised 2011 reports were submitted to rectify inaccuracies and to report new transactions that had not been previously filed. During the 2010/2011 period, RTS did not have the proper checks and balances to monitor production and to ensure that open tax payables were appropriately captured and reported to the states. Revisions have been made to corporate procedures to monitor the sub ledger and ensure that open balances, which include surplus lines taxes are closed. In addition, considerable changes have been made to the agency management system to capture data required in order to accurately and timely report surplus lines taxes and/or stamping fees (if applicable) to states. Additional changes are being made to address exempt transactions; however, after review of all Alaska transactions, only one transaction qualified as exempt. A revised 2011 annual report was submitted on November 16, 2012 resulting in a \$3.70 credit.

The structure of the surplus lines department has also changed. The team is managed by the Director of Compliance with the assistance of a Compliance Manager. Two Surplus Lines Supervisors report to the Compliance Manager. These two supervisors work with the teams to ensure that tax filings are accurate, which include the receipt and accuracy of documents from the broker teams. All tax reports and check requests generated by surplus lines coordinators are reviewed and approved by the surplus lines supervisors prior to submission to the states. A

deadline database has also been created that tracks monthly, quarterly, semi-annual and annual deadlines for all states in an effort to prevent late filings.

2. Verify the accuracy of the premium calculation

AS 21.34.180

Comments: The premium was calculated accurately for all 50 files.

Results: Passed (error rate 0%)

3. Verify the accuracy of all monthly reports and quarterly reports filed

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

Comments: Thirteen policy files had at least one issue that resulted in inaccurate reports when filed.

- Transaction not filed in original report – 8
- Endorsement not filed – 1
- Exempt form not filed and no taxes & fees should have been paid – 1
- Original transaction had incorrect premium but was corrected prior to audit – 1
- Multi-state allocation form missing – 4

Total accuracy errors: 15 within 13 distinct files

All new 2011 monthly reports were filed on 3/30/12 to rectify much of the inaccuracies the broker found on the original monthly reports as filed. Many new transactions were included in these re-filed reports.

These errors affect two other audit tests:

1. Accuracy of Tax Reports
2. Accuracy of Tax and Fee Payments

Results: Failed (37 files passed & 13 failed, error rate 26%)

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 procedures. A second individual reviewing documents before submission could reduce the number of errors received by the Division. The endorsement originally not filed now needs to be filed on a monthly report and to be included in the 2012 annual premium tax report. An amended 2011 annual premium tax report is needed to reduce the amount of tax and fees for the exempt transaction.

Broker response: See response under #1.

4. Verify the multi-state placements are filed correctly

AS 21.34.180

Comments: The broker writes some multi-state policies. For those in the audit sample, the percentage of risk allocated to Alaska appears reasonable.

Results: Passed (error rate 0%)

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

AS 21.34.180, 3 AAC 21.550 and .560

Comments: The broker was not required to file quarterly tax reports for the two audit years. The two annual premium tax reports were filed on time.

Results: Passed (error rate 0%)

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

AS 21.34.180, 3 AAC 21.550 and .560

Comments: The broker was not required to file quarterly tax reports for the two audit years. The 2011 annual premium tax report was not accurate when originally filed and it was difficult to determine what policies were included with the original report. All new monthly reports for 2011 were filed after the due date of the annual tax report which included additional transactions some of which were on the original annual tax report as filed. There was lots of communication back and forth trying to clear up the report.

In addition, the errors found during the audit in the accuracy of the monthly reports procedure test affected the accuracy of the annual tax report. These flow-through findings are addressed in their respective audit tests.

Results: Failed (1 report passed & 1 failed, error rate 50%)

Recommendation: It is recommended that the broker create written procedures to ensure all transactions are corrected reported on the tax reports. This requirement is based on law that was effective prior to 7/21/11 and will no longer be in effect after all transactions, such as endorsements and insurance company audits, for policies effective prior to 7/21/11 are completed. A second individual reviewing documents before submission could reduce the number of errors received by the Division.

Broker response: See response under #1.

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

AS 21.34.180, 3 AAC 21.550 - .570

Comments: The two annual payments and the two quarterly payments (new law effective 7/21/11) were made on or before the required due dates 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 21.550 - .570

Comments: All tax and fee payments made by the broker were accurate based upon the reports as originally filed. After corrections were made to the reports prior to the audit, payments were made by the due date requested by the Division. The errors found during the audit in the accuracy of the monthly reports test affect the accuracy of the tax and fee payments. This flow-through finding is addressed in its respective audit test.

Results: Passed (error rate 0%)

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

AS 21.34.020, 3 AAC 25.010 and .035

Comments: The broker had elected to use the Affidavit of Due Diligence for documenting the diligent search. Eleven files have problems with that documentation:

- No documentation in file – 2
- Affidavits received after binding – 9

Results: Failed (39 files passed & 11 failed, error rate 22%)

Recommendations: It is recommended that the broker modify their written procedures to ensure all Affidavits of Due Diligence are received prior to binding including those with risks located on the placement list as required by Alaska law. If another form of documentation is maintained, there must be clear indications that the declinations were done before binding or an accurate description of how the risk is qualified on the placement list.

Broker response: The majority of Alaska business is generated from the Seattle, Washington location. This staff has been reminded that receipt of the Diligent Effort Search affidavits is required prior to binding coverage. Most states require that the diligent effort search be performed prior to seeking coverage in the non-admitted market, but they do not require the wholesaler (surplus lines broker) to be in receipt of the affidavit prior to binding. The wording on the Alaska State Sheet published on our internal intranet highlights this requirement as a reminder to personnel.

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

AS 21.34.100(e)

Comments: Thirteen files demonstrated a problem with the required disclosure stamp on the evidence of insurance. Since the insured's copy is unavailable, auditor relied upon the broker copy. Here are the different problems found in the files:

- No stamp on dec - 4
- No stamp on binder/confirmation of coverage – 5
- No stamp on endorsement – 4
- Stamp illegible on dec – 1
- Broker name not on dec – 1

Total disclosure errors: 15 within 13 distinct files

Results: Failed (37 files passed & 13 failed, error rate 26%)

Recommendations: It is recommended that the broker modify written procedures for the exact wording of the stamp and ensure the procedures are followed that all evidence of insurance have the required disclosure stamp wording and is legible. The stamp should be located on the first page of the declaration so the insured will not miss it. It is further recommended to revise the written procedures to include the stamp requirement on all premium bearing and non-premium bearing endorsements as they are also evidence of insurance. One last recommendation is to ensure the broker's name is included on all evidence of insurance.

Broker response: RTS has electronic stamps for use by the broker teams. When this matter was brought up during the audit, the stamp was immediately corrected to include the name of the company and license number. The Compliance Director sends bulletins to RTS personnel via "Compliance Alerts" or "DID YOU KNOW" communications. Communications were sent to all RTS personnel reminding them to include the stamp on all evidence of insurance including endorsements.

11. Review notification for use of non-admitted insurer

AS 21.34.110

Comments: The broker attempts to include the notification that the insurance is being placed with a company that is not regulated by the Alaska Division of Insurance in their email to the retailer with the quote. However, there were nine files where no notification was maintained in the insured's file and no documentation indicating it was provided to insured.

Results: Failed (41 files passed & 9 failed, error rate 18%)

Recommendations: It is recommended that the broker revise their written procedures to ensure a copy of the notification is maintained in the insured's file. The information should include the three points of the notification: the company does not have a certificate of authority, they are not regulated by the Alaska Division of Insurance and in the event of insolvency losses will not be covered by the Alaska Insurance Guaranty Association Act. A contract of insurance placed by

the surplus lines broker is not binding upon the insured and a premium charged is not due and payable until such notification is provided to the insured.

Broker response:

- a) The Alaska Notice 21.34.110 was added to the RTS agency management system to be generated by the teams when producing quotes.
- b) Wording was amended to read: "R-T Specialty, LLC, acting on behalf of your insurance broker, will place coverage with an insurer(s)..."

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 surplus lines companies.

Results: Passed (error rate 0%)

13. Review notice regarding nonrenewal and premium increase
--

3 AAC 25.050

Comments: Eleven files did not have evidence of the required Alaska Policyholder Notice of nonrenewal and premium increase being sent to the insured with the policy or the confirmation of coverage. One file included the notice but it was an older version than required.

Results: Failed (39 files passed & 11 failed, error rate 22%)

Recommendations: It is recommended that the broker revise their written procedures to include a step in the processing of the policy, binder, and confirmation of coverage to ensure the notice is included from the insurance company. If the notice is outdated or missing, the broker should contact the insurance company to replace the notice. A step on a checklist is one way to ensure this document is reviewed.

Broker response: The Teams have been reminded to include this notice when applicable. The Compliance Department has created a policy file checklist to be utilized by the broker teams which includes this notice for Alaska business. Rollout of this checklist is scheduled in Q1'13.

Violation of Alaska Statute 21.34.180(b)

Documentation in one file shows the broker paid the premium tax on an inspection fee to the Alaska Division of Insurance but did not collect the tax from the insured thus violating the law of not allowing a broker to absorb or rebate the taxes.

Broker response: The auditor discussed this with the Seattle Office President who was aware of this transaction. He understands the seriousness of rebating and has provided assurance that this will not be a repeat offense.

SUMMARY AND SUBSEQUENT EVENTS

Summary

This was a premium tax audit of R T Specialty LLC. The auditor tested 13 standards focusing on the broker's filing of monthly, quarterly and annual reports and the subsequent payment of premium taxes and filing fees as well as disclosure, due diligence and notification requirements for using a non-admitted insurer.

The Director of Brokerage Regulation & Compliance and staff were cooperative during the audit. The tax auditor appreciated this attitude and enjoyed working with R T Specialty LLC's management and staff.

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

- 1) Many monthly reports were not filed on time or accurate. Numerous transactions were filed late, subjecting the broker to penalties.
- 2) The diligent search in the admitted market was not documented prior to binding in several files.
- 3) The disclosure stamp was missing from some of the evidence of insurance.
- 4) The required notification to the insured regarding the use of a nonadmitted insurer was not found in several files
- 5) The Alaska Policyholder Notice was missing from several files.
- 6) The broker absorbed the tax on one policy's inspection fee in violation of law.

Re-Audit

In closing, the auditor's recommended actions should help the broker correct the problems encountered. It is recommended that R T Specialty LLC be re-audited within the next three years to ascertain compliance.

Submitted by:
Rebecca Nesheim
Tax Auditor

Affidavit

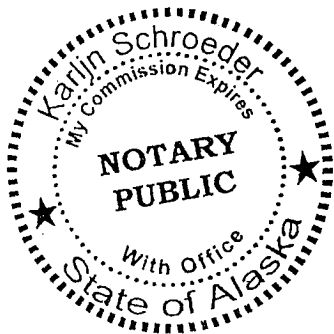
R T Specialty LLC
As of December 31, 2011
TA 12-05

Juneau, Alaska)
January 8, 2013)
State of Alaska) ss.
First Judicial District)

I, being duly sworn, do verify that the report of premium tax audit as of December 31, 2011 of R T Specialty LLC is true to the best of my knowledge and belief.

Rebecca Nesheim
Rebecca Nesheim
Tax Auditor

SUBSCRIBED and SWORN to before me this 8th day of January, 2013



Karin Schroeder
Notary Public in and for Alaska
My Commission Expires With office