

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 06-02)
In the Matter of Audit of)
Swett & Crawford Corporation)
_____)

FINDINGS OF FACT

1. An audit report of Swett & Crawford Corporation, licensed in the state of Alaska, has been issued by the State of Alaska, Division of Insurance to Swett & Crawford Corporation.
2. The audit report of Swett & Crawford Corporation (TA 06-02) has been transmitted to Michael E Hamby, Compliance Officer, Swett & Crawford Corporation (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

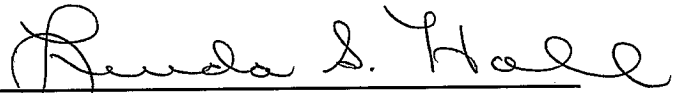
IT IS ORDERED

1. Pursuant to AS 21.06.150(b)(1), the audit report of Swett & Crawford Corporation (TA 06-02) 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. 23, 2007.

Dated this 23rd day of Jan, 2007 at Juneau, Alaska.



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

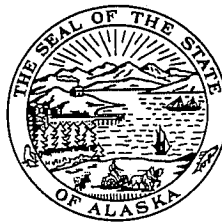
PREMIUM TAX AUDIT OF

**Swett & Crawford Corporation
Seattle, WS**

TA 06-02

As of December 31, 2005

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



**FINAL REPORT:
January 23, 2007**

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DEPARTMENT OF
COMMERCE
COMMUNITY AND
ECONOMIC DEVELOPMENT

Division of Insurance

Sarah Palin, Governor
William C. Noll, Commissioner
Linda S. Hall, Director

December 6, 2006

Linda S. Hall, CPCU, CIC
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 Swett & Crawford Corporation (the broker) on July 24 through July 28, 2006, in the broker's Seattle, WA office. The audit was conducted by Rebecca Nesheim, tax auditor for the Alaska Division of Insurance.

Swett & Crawford Corporation

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 Swett & Crawford Corporation conducted by the Alaska Division of Insurance.

Subject Matters Audited

Swett & Crawford Corporation is a licensed surplus lines broker in Los Angeles, CA with an office in Seattle, WA. The Seattle location was licensed separately until September 7, 2005 and this audit covered transactions only placed in this location. As this agency ranked number two in premium volume among all Seattle surplus lines brokers in 2005 for premium tax and filing fees paid, the division elected to audit their monthly filings, premium taxes paid, and filing fees paid, for accuracy and timeliness.

Time Frame

The audit covered this broker's surplus lines business for the two years of January 1, 2004 through December 31, 2005.

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METHODOLOGY

The tax auditor sent the call letter and initial data requests to Swett & Crawford Corporation's office in Los Angeles, CA. A list of all Alaska surplus lines business transactions was requested for the period to be audited for the Seattle, WA location. Swett & Crawford Corporation complied timely with all data requests. The number of policies and endorsements written during the audit period were 398, 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 report summaries and report of surplus lines transactions were filed in a timely manner.
 - i) Audit steps taken:
 - (1) Verified the monthly reports were filed timely with the Alaska Division of Insurance as required by statute.
 - (2) Verified the affidavit of due diligence was filed with the Alaska Division of Insurance as required by statute for those policies effective prior to July 1, 2004.
 - (3) 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.
- 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 quarterly or annual 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
 - 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 timing of authorization to bind
 - i) Audit steps taken:
 - (1) Verified the authorization to bind was received before the binder was extended to the insured.
- 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 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 in a timely manner.
AS 21.34.080 and .170, 3 AAC 25.100 and 25.090

Comments: The 24 monthly premium reports and accompanying forms were all filed timely. Each monthly filing had the correct forms attached: monthly premium report summary, report of surplus lines transaction, affidavit of due diligence (up until the statute change) and statement of

exempt premiums (when necessary) except for one. As noted in #3 further in the report, July 2005 did not have a report of surplus lines transaction form for an exempt policy although the statement of exempt premiums was filed. The broker does not write many exempt policies; thus, was unaware the form was required.

Result: Passed (error rate 0%)

2. Verify the accuracy of the premium calculation

AS 21.34.180

Comments: The broker has a manual system set up for ensuring the accuracy of the premium calculation. The Branch Administrative Manager exports a tax report from WinBroker, the broker's in-house created software, to Excel. She has to manually check the binders with the report of surplus lines transactions received against the Excel spreadsheet. In one file, the broker missed a \$50 inspection fee the insurer charged. Since the amount of taxes and fees related to this error is so minor, the Division will not pursue collection of \$1.85.

This incorrect premium error affects three other tests in the audit:

1. Accuracy of the monthly report
2. Accuracy of the quarterly and annual tax reports
3. Accuracy of the premium tax and filing fee payments.

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

Observations: The manual process created by Swett & Crawford Corporation for premium calculation is prone to errors.

Recommendations: It is recommended that Swett & Crawford Corporation enforce the written procedures to ensure no company fees are missed during the preparation of the monthly reports. It is further recommended that training be provided for those individuals inputting information into Winbroker for what is included in taxable premium. Numerous manual changes on the monthly reports are required when the premium is printed inaccurately on the monthly reports.

Once the needed procedures are in place to correct the premium calculation, the other three accuracy tests will be automatically corrected.

Swett & Crawford Corporation response to exception report: 8/25/2006: Please note Swett & Crawford strives to maintain the highest standard of quality and control over all aspects of our operations. We are looking in several ways and areas, at identifying and eliminating many manual-processing steps involved in our current Alaska tax filing procedures that will prove successful in alleviating most future inaccuracies. Our Chief Administrative Office is looking for ways to improve our operations, efficiency and on a broad basis, including these issues.

3. Verify the accuracy of all monthly reports filed

AS 21.34.080 and .170, 3 AAC 25.100 and 25.090

Comments: Winbroker prints the report of surplus lines transaction form then the Branch Administrative Manager has to fill in any missing information. She compiles the forms (now from all branches with the same FEIN) into a new spreadsheet manually and compares them to an exported tax report from Winbroker into Excel that is created by the invoice date. The software also does not include brackets or any other identifier that shows when there is return premium. Three files contributed to inaccurate originally filed monthly reports for various reasons. One file was an exempt policy for which a report of surplus lines transaction form was not included. The broker was unaware this form is still required for exempt policies. Two files had transactions that did not show up on the original Winbroker report for the July month and thus were missed until future exported tax reports showed the transactions. Amended reports were completed for the correct month when found.

Numerous minor errors are regularly found in the monthly filings as received by the Division of Insurance. Examples are the total premium on the report of surplus lines transactions for an insurance company not matching the monthly premium report summary; policy codes not matching between the two forms; return premium not accurately reflected in the correct column on the summary form; incorrect insurance company reflected on the forms. The annual tax reports as filed for 2004 and 2005 did not match the monthly reports. Lots of work went into reconciling these reports by the auditor, the Branch Administrative Manager and the Accountant and in the end it was determined the monthly reports did not include some transactions and some premiums were not accurate in the monthly reports as reflected on the annual tax report. Amended transactions were received. The major issues that affected the reports or entire missing forms are the ones concentrated on during this audit.

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

Observations: The manual process created by Swett & Crawford Corporation for report completion is prone to errors.

Recommendations: It is recommended that Swett & Crawford Corporation enforce new procedures identified during the week the auditor was in the office to include a second individual reviewing the monthly forms for accuracy and to use an end date for the tax report from Winbroker in the current month to catch those policies with effective dates in the reporting month but not invoiced until the subsequent month. A second report from Winbroker should be run just before sending the monthly report to the Division to pick up any late invoiced transactions. It is further recommended to implement a new procedure discussed to use the tax run spreadsheet from Winbroker and adding needed columns instead of recreating the transactions on a new spreadsheet. This should reduce the number of human errors on the monthly reports.

Swett & Crawford Corporation response to initial exception report: 8/25/2006: Swett & Crawford appreciates the Division's assistance, your time and resources to help reconcile

previous tax report concerns. We think you will note our results are vastly improved when compared to previous years. We will be looking at implementation of additional control procedures, to reduce errors and workload. We do realize input errors create additional workload and we are committed to improve our performance and accuracy. In the interim, tax reports that are run by transaction date will be rerun prior to finalizing all monthly reports. These reports should include any late bookings and allow those transactions to be included with the proper statement. We will use Excel spreadsheets generated or reports otherwise from Winbroker whenever possible.

4. Verify the multi-state placements are filed correctly

AS 21.34.180

Comments: Six policies within the sample had multi-state transactions. When discussed with compliance officer/president, he said they do the best they can but it is often difficult to determine the best allocation method. The files in the sample showed a reasonable allocation between Alaska and other states.

Result: Passed (error rate 0%)

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

AS 21.34.180, 3 AAC 21

Comments: Two out of the 10 tax reports were filed late with the division. The quarterly tax reports are filed out of the Georgia office.

Result: Failed (8 tax reports passed & 2 failed, error rate 20%)

Recommendations: It is recommended that Swett & Crawford Corporation create written procedures to ensure all offices know which aspects of the statute and regulations they are responsible for and that the required paperwork is sent to the Alaska Division of Insurance timely.

Swett & Crawford Corporation response to initial exception report: 8/25/2006: We are reviewing all we do, in this response to ensure we act correctly. In this case, both reports were produced, however we neglected to forward reports along with tax payments. While this is not an excuse, we do note that 3rd quarter 2005 was our first reporting as a private company and our procedures were not fine-tuned yet. Previously the quarterly reports were included in the procedure to wire transfer funds to Alaska. Currently, the transfer of funds to Alaska is initiated on-line through the Alaska website and is on the form of an ACH. We have added the following to the ACH transfer procedures: "Complete Surplus Line Brokers Quarterly Tax Report (attached) and mail to Alaska address on form."

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

AS 21.34.180, 3 AAC 21

Comments: Both annual tax reports were not accurate when filed because the monthly reports were not accurate. The 2004 report was reconciled prior to audit with a tremendous amount of work between the auditor and Swett & Crawford staff. The actual figures on the annual tax report changed after the reconciliation resulting in a refund of \$965.30. The 2005 report was reconciled during this current audit. Other than one unauthorized issue addressed in #11, the rest of the annual tax report was correct, again the monthly reports were found to not be accurate and on audit, the auditor received corrected transaction reports. There is a refund of \$726.69 on the 2005 tax report. Therefore, there is a total refund for the audit of \$1,691.99. Several of the audit findings affect the accuracy of the tax reports but had the premium calculation and the monthly reports been accurate, the tax reports would also have been accurate except for 2004. Therefore, all but the 2004 annual tax reports are considered accurate.

Result: Failed (9 tax reports passed & 1 failed, error rate 10%)

Recommendations: It is recommended that Swett & Crawford Corporation enforce new procedures identified during the week the auditor was in the office for decreasing the errors on the monthly filings. Those changes should provide for the annual tax payment report to reconcile with the monthly premium report summaries as required by regulation.

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

AS 21.34.180, 3 AAC 21

Comments: The 10 payments were all made by the due dates and by ACH as required.

Results: Passed (error rate 0%)

Observations: Swett & Crawford Corporation consistently ensures payments are received by the due date.

8. Verify tax and filing fees payments were made accurately

AS 21.34.180, 3 AAC 21

Comments: The payments were made accurately based upon the tax reports as filed. During the audit, several filings were found to be inaccurate. Had the monthly reports been accurate, the tax reports would have been accurate and the corresponding tax and fee payments would have been accurate. The only reason the payments were not accurate is the audit findings. Therefore, the tax and filing fee payments are considered accurate.

Results: Passed (error rate 0%)

Observations: Swett & Crawford Corporation consistently ensures all their tax and filing fee payments match the quarterly and annual premium tax reports as filed.

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

AS 21.34.020, 3 AAC 25.030

Comments: One file did not contain an affidavit of due diligence or any other indication that the admitted market was evaluated prior to going surplus lines. The Branch Administrative Manager also looked through the file and found indications that the affidavit was requested of the producer but after the determination that the insured was exempt from tax and fees, the follow-up was dropped. Her assumption is the staff working on the file figured that being exempt there was no longer a requirement for the affidavit. Assured her it was still a requirement.

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

Recommendations: It is recommended that Swett & Crawford Corporation ensure there is documentation in each surplus lines transaction file meeting regulation requirements for due diligence. Although the affidavit of due diligence is no longer required per regulation, the broker has the right to request the form from the producers they work with in order to maintain the required file documentation.

Swett & Crawford Corporation response to initial exception report: 8/25/2006: As we noted, in the file discussed, the retail broker was adamant this was exempt and on the surplus lines placement list, and therefore would not provide the affidavit. As you know, Swett & Crawford is not in the position to approach the majority of admitted markets for Alaskan insured's. Furthermore, we do not always have leverage over the producing brokers interest in supplying this documentation, however, Swett & Crawford will mandate that our agents supply an affidavit of due diligence or other documentation prior to binding any non-admitted business in Alaska.

10. Review disclosures for use of non-admitted insurer

AS 21.34.110

Comments: There was no documentation in 47 of the files showing Swett & Crawford Corporation met the requirements in Alaska statute 21.34.110 that requires notification by either the producer or the surplus lines broker to the insured in writing, a copy of which shall be maintained by the surplus lines broker with the records of the contract, available for examination, 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. A contract of insurance placed by the surplus lines broker under chapter 34 is not binding upon the insured and a premium charged is not due and payable until such notification is provided to the insured. One file had a stamp used on the pertinent documents stating the required language in statute.

Results: Failed (2 files passed & 48 failed, error rate 96%)

Recommendations: It is recommended that Swett & Crawford Corporation continue to use the new service fee disclosure to provide the required notification to the insured in addition to information regarding the broker fee being charged.

Swett & Crawford Corporation response to initial exception report 8/25/2006: As you are aware, Swett & Crawford is a wholesale insurance broker whose contact throughout any transaction is always through the independent agent. Swett relied upon the agent, who has direct contact with the insured, for the required notification. Swett did use a stamp on all evidence of insurance, quotes and binders produced through our office indicating coverage was with a non-admitted carrier and not subject to the guaranty fund. However, we have and will continue to use our newly minted service fee disclosure notice along with the new stamp wording.

Division of Insurance Response: A stamp will not meet statute requirements. This is intended to be another opportunity to inform the insured of the surplus lines coverage. The latest this notice may be provided to the insured is with the invoice. A best practice might be to send your disclosure notice with the quote.

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

AS 21.34.050

Comments: One file in the audit sample showed the placement was made with an insurance company that was not on the white list at the time. There were several other placements found while in the planning stage for the audit that were also placed with ineligible insurance companies. They are not part of the audit but since they were found, will be addressed in regards to the filing and payment requirements. DOI will return .7% of the taxes and filing fees paid so that the broker can refund the insured.

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

Recommendations: It is recommended that Swett & Crawford Corporation create written procedures to ensure the insurance company is eligible at the time a placement is written by using the company query on the Alaska Division of Insurance's web site. By the time the report of surplus lines transaction is signed it is too late. Although, it would be prudent for Swett & Crawford to include a new procedure for those preparing and reviewing the monthly reports to double check that the insurance company was eligible.

Swett & Crawford Corporation response to initial exception report 8/25/2006: As we explained, Swett & Crawford has a committee that reviews and approves all carriers with which business is placed. We pride ourselves on the use of only the most qualified and highly rated carriers. In this file, Swett & Crawford placed coverage for this insured effective 1/1/2004. In 2004 the carrier was on the Alaska approved carrier list. Swett & Crawford does have procedures, in place; regrettably this carrier's removal was missed at the renewal of this account. Upon discovery and after many discussions with the carrier we were informed they were placed on the list effective July 2005. We will continue to review and address this matter.

12. Review timing of authorization to bind

AS 21.34

Comments: Documentation was in every file showing the authorization to bind from the producers was received prior to binding coverage.

Results: Passed (error rate 0%)

Observations: Swett & Crawford Corporation maintains the necessary documentation, whether it is in the form of a fax, email, or phone call.

13. Review notice regarding nonrenewal and premium increase

3 AAC 25.050

Comments: Twelve files for which the broker has contractual authority did not have the required notification per regulation.

Results: Failed (38 files passed & 12 failed, error rate 24%)

Recommendations: It is recommended that Swett & Crawford Corporation ensure the new procedures are followed to ensure that all policies from insurance companies for which they have contractual authority contain the nonrenewal and premium increase notification. It is also recommended to review all policies received from other insurance companies for the notification and follow up on missing ones.

Swett & Crawford Corporation response to initial exception report: 8/25/2006: As we explained, upon receipt of Alaska Bulletin B 06-10, providing the approved wording to comply with 3 AAC 25.050, Swett & Crawford will attach the approved Alaska Policyholder notice to all evidence of insurance we produce. As we discussed, although Swett & Crawford has authority to issue St. Paul policies, we don't have final authority as to forms and wording. We showed correspondence from St. Paul indicating their legal department did not want to attach the notification to our policies.

SUMMARY AND SUBSEQUENT EVENTS

Summary

This was a premium tax audit of Swett & Crawford Corporation. 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 very cooperative during the audit. The tax auditor appreciated this attitude and enjoyed working with Swett & Crawford Corporation's management and staff.

Several significant issues did arise during the audit.

- 1) Several of the monthly reports were not accurately filled out which leads to inaccurate tax reports and inaccurate premium tax and filing fee payments. Once the root cause of the

inaccuracies is fixed with the recommendations laid out by the auditor, the resulting inaccuracies should be corrected.

- 2) Several transactions used an insurer not eligible at the time of placement. This affects the insured in several ways, including an overpayment of taxes and fees.
- 3) The required notification to the insured regarding the use of a non admitted insurer that is not regulated by the Alaska Division of Insurance, does not have a certificate of authority and is not covered by the Alaska Guaranty Association in the case of insolvency was not found in the majority of files.

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 is evident in the response to the exception report. The auditor's recommended actions, including those already implemented by the broker, should correct the problems encountered and it is recommended that Swett & Crawford Corporation be re-audited within the next three years to ascertain compliance with them.

Submitted by:
Rebecca Nesheim
Tax Auditor

Swett & Crawford Corporation
As of December 31, 2005
TA 06-02

Juneau, Alaska)
December 6, 2006)
State of Alaska) ss.
First Judicial District)

I, being duly sworn, do verify that the report of premium tax audit as of December 31, 2005 of Swett & Crawford Corporation is true to the best of my knowledge and belief.

Rebecca Nesheim
Rebecca Nesheim
Tax Auditor

SUBSCRIBED and SWORN to before me this 6th day of December, 2006



[Signature]
Notary Public in and for Alaska
My Commission Expires 1/24/2009