

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 18-03)
In the Matter of Audit of)
Lockton Affinity LLC)
_____)

FINDINGS OF FACT

1. An audit report of Lockton Affinity LLC, licensed in the State of Alaska, has been issued by the State of Alaska, Division of Insurance to Lockton Affinity LLC.
2. The audit report of Lockton Affinity LLC (TA 18-03) has been transmitted to Jeffrey Hewitt, Compliance Officer, Lockton Affinity 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 Lockton Affinity LLC (TA 18-03) 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 March 8th, 2019.

Dated this 8th day of March, 2019 at Juneau, Alaska.



Lori Wing-Heier, Director
State of Alaska
Division of Insurance

PREMIUM TAX AUDIT OF

**Lockton Affinity LLC
Overland Park, KS
Alaska License #10851**

TA 18-03

As of December 31, 2017

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



**FINAL REPORT:
March 8, 2019**

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March 8, 2019

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Lori K Wing-Heier
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Pursuant to Alaska Statute (AS) 21.06.120, the Alaska Division of Insurance performed a limited and targeted premium tax audit of Lockton Affinity LLC. The audit was conducted by Rebecca Nesheim, tax auditor for the Alaska Division of Insurance.

Lockton Affinity 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, the premium tax regulations 3 AAC 21.550 – 570 and licensing statutes AS 21.27.350 and 21.27.810. This is the first premium tax audit of Lockton Affinity LLC conducted by the Alaska Division of Insurance (the division).

Subject Matters Audited

Lockton Affinity LLC (the broker) is an Alaska licensed surplus lines broker based in Overland Park, KS. The division elected to audit their quarterly filings, premium taxes and filing fees paid for accuracy and timeliness as well as required diligent search efforts, disclosures, notifications, and prompt delivery of material facts in evidence of insurance to the insured.

Time Frame

The audit covered the broker's surplus lines business for policy effective dates occurring between January 1, 2016 and December 31, 2017.

METHODOLOGY

The division sent the call letter and initial data requests to the broker's office in Overland Park, KS. 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 317, from which a sample of 50 files was selected for audit. One of the files was a master policy and as Alaska considers each insured added to a master policy a separate file, all 33 insureds of the master policy were added to the audit. However, it was determined the home state for two of the master policy insureds was not Alaska so those were not reviewed for any audit test except for home state. The total number of files audited became 81 for most tests. One test remain at the 50 files.

The following are the procedure steps for the audit:

- 1) Verify that quarterly reports and accompanying forms were filed on time.
 - i) Audit steps taken:
 - (1) Reviewed the quarterly reports sent to the Alaska Division of Insurance and verified they were filed by the due date.
- 2) Verify the accuracy of the premium calculation.
 - i) Audit steps taken:
 - (1) Reviewed policy, binders, 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 quarterly reports filed.
 - i) Audit steps taken:
 - (1) Reviewed the policy, binder, and endorsement pages in each file.
 - (2) If the effective date did not match the 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 invoice date determines in which quarter the endorsement is required to be filed.
 - (3) Verified the 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 quarterly filing based upon the effective date of the policy.
 - (6) Verified the insured name, insurance company, policy type codes, producer names and license numbers were accurate on the forms filed.
 - (7) Verified the descriptions of the subject and locations of risk were identified on the reports.
- 4) 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.
- 5) Verify tax and filing fee payments were made accurately.
 - i) Audit steps taken:

- (1) Confirmed if the tax and fee payments matched the quarterly reports as filed.
- 6) Confirm Alaska is the home state of the insured.
 - i) Audit steps taken:
 - (1) Verified where the principal place of business or residence of the insured is located.
 - (2) Verified at least partial risk is located in Alaska or the highest % of premium in Alaska if headquarters not in Alaska with no risk in the headquarters state.
- 7) 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 received within 15 days from binding. If there were 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
- 8) Review prompt delivery of evidence of insurance AS 21.34.100(a) and 3 AAC 25.060.
 - i) Audit steps taken:
 - (1) Reviewed dates of binding and forwarding evidence of insurance to insured.
- 9) Review required material facts are located on evidence of insurance AS 21.34.100(a).
 - i) Audit steps taken:
 - (1) Reviewed documents to confirm required material facts were located on the evidence of insurance when policy not available within 30 days of binding.
- 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 language 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 Alaska published white lists and NAIC Quarterly Listings of Alien Insurers 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 there was an Alaska Policyholder Notice regarding nonrenewal and premium increase included with the policy in the format approved by the Director of the Alaska Division of Insurance.
- 14) Other issues not previously identified as a procedure step were included when not in compliance with Alaska laws.
 - i) Audit steps taken:
 - (1) Reviewed documents to ensure other surplus lines statutes and regulations requirements were met.

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

Comments: The eight original quarterly reports with accompanying forms were filed on time.

Results: Passed (error rate 0%)

- | |
|---|
| 2. Verify the accuracy of the premium calculation
AS 21.34.180 |
|---|

Comments: The premium was not correctly reported for the June 2016 master policy bordereau, which is a summary of each month's new insured additions and endorsements to the master policy. The difference is negligible and will result in negligible taxes and filing fees; however, the 2nd Quarter 2016 Report will need to be amended due to audit test six so the negligible difference needs to be corrected. For the master policy, each insured was determined to be on the specific monthly bordereau then the bordereau's were evaluated against the Quarterly Reports as filed. For purposes of the error rate, each insured's premium was accurate but as a summary, the one incorrect bordereau premium not being reported correctly will be one error out of 50 instead of the 81 total files.

This error affects two additional audit tests:

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

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

Recommendations: It is recommended the broker create Alaska specific written procedures to ensure all premiums are reported accurately. This error should correct itself once each insured is reported individually as required in audit test two instead of summarizing each bordereau.

The broker's response: even though we passed this section, corrections were made on the June 2016 and October 2016 reports to correctly display what should have been submitted at those time periods. This data was reported to the Tax Auditor on 02/11/2019 by Bishop.

- | |
|---|
| 3. Verify the accuracy of all quarterly reports filed
AS 21.34.080 and .170, 3 AAC 25.090 and .100 |
|---|

Comments: Multiple errors were noted on the Report of Surplus Lines Transaction forms and Quarterly Reports filed with the division:

- Insured address incorrect – 14
- Policy # incorrect – 2
- Master policy insured's not reported individually – 31

Total accuracy errors: 47 within 45 distinct files

One endorsement was filed using the effective date instead of the invoice date but within the same quarter. There was one master policy filed on the wrong month's bordereau using the invoice date instead of effective date but within the same quarter. There was no effect on the respective quarterly reports or the taxes and fees so will not be considered an error for this audit but this will need to be fixed for future reports so as not to cause a filing made to the wrong quarter report.

Results: Failed (36 files passed & 45 failed, error rate 56%)

Recommendations: It is recommended the broker revise their Alaska specific written procedures to include instructions on how to fill out the transaction report. Procedures should include what data is entered into each field. Specific instructions for how to report endorsements should also be included. For all master policies, the Alaska insured's must be reported individually. A second individual reviewing documents before submission should reduce the number of errors received by the division.

The broker's response: It is Lockton's understanding that the failure was attributable to 31 policies imbedded in a Master Policy/General Liability and 14 policies were attributable to not having the correct address of the insured reported. The insured's noted in the master policy are being corrected at the time of this writing, being individually reported, and will be completed by the time this report is received.

In addition to the above, our plan is to assign a second tax specialist within the department for double-checking submissions and be the second set of eyes to guarantee accuracy on the data that is being reported.

<p>4. Verify if tax and filing fee payments were made on time and by ACH AS 21.34.180, AS 21.34.190, 3 AAC 21.550 - .570</p>
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Comments: All payments were made on or before the required due date for the quarterly payments and made by ACH.

Results: Passed (error rate 0%)

<p>5. Verify tax and filing fees payments were made accurately AS 21.34.180, 3 AAC 21.550 - .570</p>
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Comments: All tax and fee payments made by the broker were accurate based upon the quarterly reports as filed. The errors found during the audit in the premium calculation and home state of the insured affects the accuracy of the tax and fee payments. These flow-through findings are addressed in their respective audit tests.

Results: Passed (error rate 0%)

6. Verify the home state for insured is Alaska

AS 21.34.180

Comments: The home state of the insured was evaluated for all policies. Two insureds part of the master policy are headquartered outside of Alaska with no risk in Alaska. It appears the wrong state code was used in their database; therefore, Alaska is not the home state of these two policies. The broker will need to amend the affected quarterly reports to remove the two transactions and file them in the appropriate home states. The number of files to calculate the error rate will be the full number of 83.

This error affects three additional audit tests:

1. Accuracy of Premium
2. Accuracy of Quarterly Reports
3. Accuracy of Tax and Fee Payments

Results: Passed (81 files passed & 2 failed, error rate 2%)

Recommendations: It is recommended the broker create written procedures for how to determine the home state of the insured and to apply the process for each policy. A checklist to guide staff through the home state definition might be one way to put together the procedures. Backup documents should be maintained in the insured files for how the home state was determined. State codes need to be double checked to ensure accuracy if the code is used to determine in which state a specific transaction is to be filed. When the headquarters or primary residence of the insured is based outside of Alaska, as long as 100% of the risk is located out of the state in which the headquarters or primary residence reside and the largest percentage of taxable premium is allocated to Alaska then Alaska is considered the home state for that policy.

The broker's response: We feel that we have a firm and solid understanding of the definition of home state status. However, it has been reiterated again to all relative associates handling surplus business, both in back office operations as well as on the front line. It is anticipated that a tax workshop will be conducted before the end of June 2019 which will, among other concerns, provide the tools needed in obtaining a listing of all relative information pertaining to home state status. In addition, Lockton Affinity will reinforce accuracy issues with internal operations teams.

7. Review diligent search effort made to place insured with an admitted insurer

AS 21.34.020, 3 AAC 25.010 and .035

Comments: The broker is also the producing broker in their surplus lines transactions so it is their responsibility to complete the diligent search. During the two year audit period, the broker completed the diligent search once a year for all programs they write. The same diligent search efforts for each program can be used for up to 180 days for multiple insureds for the same class of insurance. There were 31 files where the diligent search was beyond the 180 days to be valid.

Results: Failed (50 files passed & 31 failed, error rate 38%)

Recommendations: It is recommended the broker create Alaska specific written procedures to ensure all diligent search for each program is completed every 180 days to ensure all policies written meet the diligent search requirements.

The broker's response: This deficiency has been corrected and was discussed with the Tax Auditor at the end of this audit. However, for this response, Lockton Affinity has implemented a twice-yearly declination refresh process rather than the previous search of once per year. This process has started and is working well as of this writing.

8. Review prompt delivery of evidence of insurance

AS 21.34.100(a) and 3 AAC 25.060

Comments: All files have documentation showing the evidence of insurance was provided to the insured within the 30 days of binding.

Results: Passed (error rate 0%)

9. Review required material facts located on evidence of insurance

AS 21.34.100(a)

Comments: Seventy-seven files were missing at least one required material facts on proof of coverage and policies. If there is a proof of coverage created, it goes to the insured at the same time as the policy so the policy was evaluated as they were all provided within 30 days of binding.

Here are the different issues that the broker is not compliant with regarding this statute:

- Dec missing broker license # - 77
- Dec missing broker name - 2

Total errors: 79 within 77 distinct files

Results: Failed (4 files passed & 77 failed, error rate 95%)

Recommendations: It is recommended the broker create Alaska specific written procedures to include what material facts regarding the coverage, insured, insurer, and broker must be on evidence of insurance. Review statute for details.

The broker's response: This area will be modified immediately by affixing the broker license number and broker name on the declaration page of each policy. This will be examined each month by the tax specialist assigned to this area.

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

AS 21.34.100(e)

Comments: All 81 files had problems with the required disclosure statement on the evidence of insurance. The disclosure statement must be word-for-word as in statute but the statement the broker uses is missing a word. Thus the 75 files that included evidence of insurance with the missing word failed. When the disclosure statement is provided with the evidence of insurance, it is on a separate piece of paper but it does not include any identifying information. Where the insured's copy was unavailable, auditor relied upon the broker copy. Here are the different problems found in the files:

- No disclosure on proof of coverage – 24
- No disclosure on dec - 6
- No disclosure on endorsement – 15
- No disclosure on certificates – 49
- Disclosure statement missing a word – 75

Total disclosure errors: 169 within 81 distinct files

Results: Failed (error rate 100%)

Recommendations: It is recommended the broker create Alaska specific written procedures to ensure all evidence of insurance have the required disclosure statement. The disclosure statement should be located on the first page of the evidence of insurance so the insured will not miss it. However, if a separate document is necessary, it must be identified as part of the evidence of insurance for the specific insured and be attached to the document. A loose document will not meet the intent of statute. It is further recommended to include the disclosure statement on all premium bearing and non-premium bearing endorsements as they are also evidence of insurance.

The broker's response: Correction has been made regarding warning language to be affixed on all evidence of insurance. This will be implemented immediately.

11. Review notification for use of non-admitted insurer

AS 21.34.110

Comments: The broker generally does not provide the notification to most insureds. Eleven files included the required 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.

Results: Failed (11 files passed & 70 failed, error rate 87%)

Recommendations: It is recommended the broker create Alaska specific written procedures to include the Alaska notification language in the proposal, when there is one, or with an email sent to the client preferably before binding but no later than with the invoice for premium payment. For those programs where the client completes an online application, it is recommended to include a checkbox with the required information not allowing the client to complete the

application unless the checkbox is completed and to maintain a copy of the checkbox approval in each insured's file.

The broker's response: Will update documents immediately to meet the AK notification standard.

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: The Alaska Policyholder Notice of premium increase and nonrenewal was not provided to 56 insureds with the policies.

Results: Failed (25 files passed & 56 failed, error rate 69%)

Recommendations: It is recommended the broker create Alaska specific written procedures to include a step in processing the policy to the insured to ensure the Alaska Policyholder Notice is provided with the policy.

The broker's response: The Alaska Surplus Lines Notice under 3 AAC 25.050 (policyholder notice) will be inserted into every policy issued. This change will begin immediately.

SUMMARY AND SUBSEQUENT EVENTS

Summary

This was a premium tax audit of Lockton Affinity LLC. The auditor tested 13 standards focusing on the broker's filing of quarterly reports and the subsequent payment of premium taxes and filing fees as well as diligent search efforts, disclosure and notification requirements for using a non-admitted insurer, and prompt delivery of material facts to insured.

The audit was conducted in the auditor's office as she received electronic versions of the broker's files under audit. The broker responded to all requests for additional information. The auditor appreciated this behavior.

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

- 1) Numerous quarterly reports were not accurate when filed.
- 2) The diligent search in the admitted market was not documented for many of the files.
- 3) Evidence of insurance provided within 30 days from binding was missing material facts.
- 4) Numerous evidence of insurance did not have the disclosure statement or the statement used was missing a word.
- 5) The required notification to the insured regarding the use of a nonadmitted insurer was not found in the majority of files
- 6) The Alaska Policyholder Notice was missing from the majority of files.

The auditor would like to review any new or revised procedures to help the broker ensure all problems identified in the audit were captured accurately.

Re-Audit

In closing, the auditor's recommended actions and review of the procedures should help the broker correct the problems encountered. It is recommended that Lockton Affinity LLC be re-audited within the next three years to ascertain compliance.

Submitted by:
Rebecca Nesheim
Tax Auditor

Affidavit

Lockton Affinity LLC
As of December 31, 2017
TA 18-03

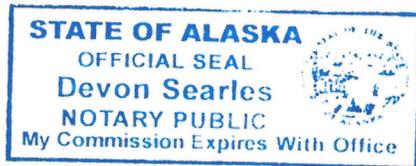
Juneau, Alaska)
March 8, 2019)
)
State of Alaska) ss.
First Judicial District)

I, being duly sworn, do verify that the report of premium tax audit as of December 31, 2017 of Lockton Affinity 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 March, 2019

Devon Searles
Notary Public in and for Alaska



My Commission Expires With Office