

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 07-02)
In the Matter of Audit of)
Patterson Insurance Brokers Inc)
_____)

FINDINGS OF FACT

1. An audit report of Patterson Insurance Brokers Inc, licensed in the state of Alaska, has been issued by the State of Alaska, Division of Insurance to Patterson Insurance Brokers Inc.
2. The audit report of Patterson Insurance Brokers Inc (TA 07-02) has been transmitted to Jacqueline R Hansen, Compliance Officer, Patterson Insurance Brokers Inc (Auditee), and Auditee has been accorded at least 30 days' opportunity to review and comment on this audit report.
3. The director of the Division of Insurance has fully considered and reviewed the report and any relevant portions of the auditor's work papers to the extent she considered necessary.

CONCLUSIONS OF LAW

1. The written audit report referred to in Finding of Fact No. 1 was issued in accordance with Alaska Statute (AS) 21.06.150(b).
2. The actions set forth in finding of Fact No. 2 were conducted in accordance with AS 21.06.150(b).
3. The director of the Division of Insurance has reviewed the audit report and any other relevant work papers as set forth in Finding of Fact No. 3 to the extent she considered necessary in accordance with AS 21.06.150(b).

ORDER

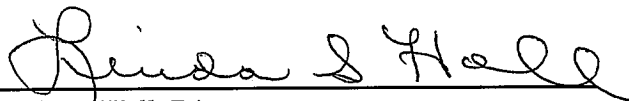
IT IS ORDERED

1. Pursuant to AS 21.06.150(b)(1), the audit report of Patterson Insurance Brokers Inc (TA 07-02) 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 September 26, _____, 2007.

Dated this 26th day of September _____, 2007 at Anchorage, Alaska.



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

PREMIUM TAX AUDIT OF
Patterson Insurance Brokers Inc
Anchorage, Alaska

TA 07-02

As of December 31, 2006

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



FINAL REPORT:
September 26, 2007

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DEPARTMENT OF
COMMERCE
COMMUNITY AND
ECONOMIC DEVELOPMENT
Division of Insurance

Frank H. Murkowski, Governor
William C. Noll, Commissioner
Linda S. Hall, Director

August 10, 2007

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 Patterson Insurance Brokers Inc (the broker) on May 24, 2007 through May 25, 2007, in the broker's Anchorage office. The audit was conducted by Rebecca Nesheim, tax auditor for the Alaska Division of Insurance.

Patterson Insurance Brokers Inc

SCOPE OF AUDIT

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

Subject Matters Audited

Patterson Insurance Brokers Inc is an Alaska licensed surplus lines broker based in Anchorage, Alaska. 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 July 1, 2005, the first month of operation after the change in ownership, through December 31, 2006.

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METHODOLOGY

The tax auditor sent the call letter and initial data requests to Patterson Insurance Brokers Inc's office in Anchorage, Alaska. A list of all Alaska business transactions with nonadmitted insurers was requested for the period to be audited. Patterson Insurance Brokers Inc complied timely with all data requests. The number of policies and endorsements written during the audit period was eight so all were selected for audit.

The following are the procedures steps for the audit:

- 1) Verify that monthly premium reports and accompanying forms were filed in a timely manner.
 - i) Audit steps taken:
 - (1) Reviewed the monthly files sent to the Alaska Division of Insurance and verified the policy was included in the monthly filing based upon the effective date of the policy.
 - (2) Verified a statement of exempt premiums was filed when appropriate.
- 2) Verify the accuracy of the premium calculation
 - i) Audit steps taken:
 - (1) Reviewed policy, declaration page, and invoices to determine how they calculated the premium.
 - (2) Verified the correct premium was reported on the monthly reports as filed.
- 3) Verify the accuracy of all monthly reports filed.
 - i) Audit steps taken:
 - (1) Reviewed the policy & declaration pages in each file.
 - (2) If the effective date did not match the monthly filing, reviewed the correspondence to ensure the documentation in the file matched when the policy was booked. Most of these occurred with endorsements that often require additional information and sometimes company approval before it can be added to the policy. The effective date may be a month or more prior to the actual book date or invoice date. In this case, the invoice date usually determined in which month the endorsement is required to be filed.
 - (3) Verified the monthly reports as filed with the division were accurately filled out to reflect the correct effective date, premiums, taxes and fees based upon the information in the files.
- 4) If the placement is a multi-state placement, check the calculation and reasonableness of the methodology to allocate.
 - i) Audit steps to take:
 - (1) Verify the allocation of premium for each state is reasonable and the calculation is accurate.
- 5) Verify quarterly, if required, 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, if required, 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 monthly reports as filed.
- 9) Review effort made to place insured with an admitted insurer
 - i) Audit steps taken:
 - (1) Verified an affidavit of due diligence was in the file and the declinations filled out or other due diligence documentation as required. 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 stamp as required in AS 21.34.100(e) was appropriately documented.
 - (2) Reviewed the correspondence and other documentation in the files to find a copy of the notification sent to the insured that meets the requirement in AS 21.34.110.
- 11) Confirm coverage is placed with an eligible non-admitted insurer
 - i) Audit steps taken:
 - (1) Reviewed the white lists to ensure the company was eligible at the time of placement
- 12) Review notice regarding nonrenewal and premium increase
 - i) Audit steps taken:
 - (1) Verified in each file there was a policyholder notice regarding nonrenewal and premium increase included with the policy or other evidence of insurance.

Acceptable Error Rate:

The Broker's acceptable error rate for the above referenced standards and tests must be less than 10%.

PREMIUM TAX AUDIT

- | |
|---|
| <ol style="list-style-type: none">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 broker started operations July 1, 2005. The 18 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, and statement of exempt premiums (when necessary).

Result: Passed (error rate 0%)

Observations: Patterson Insurance Brokers Inc consistently filed all necessary forms by the due date.

2. Verify the accuracy of the premium calculation

AS 21.34.180

Comments: The broker uses Agency Management Systems (AMS) to maintain all the policy information for each insured. They must remember to code the transaction as a surplus lines transaction. They charge a broker fee on every transaction they make but correctly omitted them from the premium calculation for the files under audit.

Result: Passed (error rate 0%)

3. Verify the accuracy of all monthly reports filed

AS 21.34.080 and .170, 3 AAC 25.100 and 25.090

Comments: The broker uses Agency Management Systems (AMS) to maintain all the policy information for each insured. They must remember to code the transaction as a surplus lines transaction. All files audited showed the monthly reports were accurately filled out except for a courtesy filing that will be discussed in a separate procedure step. Therefore, the monthly reports will be considered accurate.

Result: Passed (error rate 0%)

4. Verify the multi-state placements are filed correctly

AS 21.34.180

Comments: None of the policies under audit were multi-state so this test is not applicable.

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

AS 21.34.180, 3 AAC 21

Comments: Both annual tax reports were filed timely with the division. They did not have a quarterly filing requirement

Result: Passed (error rate 0%)

Observations: Patterson Insurance Brokers Inc consistently filed all necessary forms by the due date.

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

AS 21.34.180, 3 AAC 21

Comments: The tax reports as filed matched the monthly reports as filed. During the audit, a courtesy filing was made that was not handled appropriately for how the tax reports were filled

out in relation to this policy. The details for the courtesy filing will be in a separate procedure step. Therefore the tax report was considered filed accurately.

Result: Passed (error rate 0%)

Observations: Patterson Insurance Brokers Inc consistently ensures all their monthly filings match with the annual premium tax reports.

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

AS 21.34.180, 3 AAC 21

Comments: There was only one payment required for the audit period and it was made by the due date and by ACH as required.

Results: Passed (error rate 0%)

8. Verify tax and filing fees payments were made accurately

AS 21.34.180, 3 AAC 21

Comments: The payments for the 2006 tax and fees were made accurately based upon the tax report as filed. During the audit, a courtesy filing was made that was not handled appropriately for how the tax reports were filled out and how accurate the payment was in relation to this policy. The details for the courtesy filing will be in a separate procedure step. Therefore, the tax and filing fee payment for 2006 was considered accurate.

Results: Passed (error rate 0%)

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

AS 21.34.020, 3 AAC 25.030

Comments: All files except for the courtesy filing, which will be discussed separately, included the due diligence efforts as required.

Results: Passed (error rate 0%)

10. Review disclosures for use of non-admitted insurer

AS 21.34.110

Comments: The required notification to the insured prior to binding per Alaska statute 21.34.110 was not documented in any of the files. Statute says the premium is not due and payable until the surplus lines broker has notified 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, and, in the event of the insolvency of the surplus lines insurer, losses will not be covered under AS 21.80 (Alaska Insurance Guaranty Association Act). The courtesy filing will be discussed separately.

Alaska statute 21.34.100(e) states the evidence of insurance must include the surplus lines broker name. This can be as part of the required stamp or separate just as long as it is on the evidence.

Results: Failed (all 7 files failed, error rate 100%)

Recommendations: It is recommended that Patterson Insurance Brokers ensure that a copy of the notification they created prior to the audit and provide to the insured prior to binding be included in the marketing file. Once the broker goes fully electronic, the notification requirement can be a reference to the document that was mailed at the time of the quote in the activity log of the insured's record in the computer system.

Patterson Insurance Brokers Inc response to initial exception report June 27, 2007: At binding we will place in the marketing file, documentation signed by the client that states they are aware that their coverage has been placed with a surplus lines carrier; per AS 21.34.110 and that losses will not be covered under AS 21.80. A copy of this form was attached to the response.

Department response: The auditor read the form they will have signed by the client and it meets all the required elements in statute.

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

AS 21.34.050

Comments: All transactions within the files show approved companies.

Results: Passed (error rate 0%)

Observations: Patterson Insurance Brokers Inc appears to be careful about placing business with only those insurers on the white list.

12. Review notice regarding nonrenewal and premium increase

3 AAC 25.050

Comments: The required nonrenewal/premium increase notification per Alaska Regulation 3 AAC 25.050 that must be included in each policy from the insurance company was not in any of the seven files. The Lexington policies included the ISO Alaska changes - cancellation and nonrenewal; however, this is not the required notification for surplus lines carriers as their requirements are different than for admitted companies. The courtesy filing will be discussed separately.

Results: Failed (all 7 files failed, error rate 100%)

Recommendations: It is recommended that Patterson Insurance Brokers Inc ensure that every policy received from the surplus lines insurance companies include the required Alaska Policyholder Notice as stated in Bulletin 06-10. It is Patterson's responsibility to contact the company to include the policyholder notice in the policy if it is not provided.

Patterson Insurance Brokers Inc response to initial exception report June 27, 2007: We will be checking each and every policy to ensure that the insurance company has attached the appropriate Alaska Policyholder Notice. This will be a part of the policy check in process that has been incorporated into our procedures.

Courtesy Filing

Comments: The broker accepted a filing from a producer that did not have an Alaska surplus lines broker license but had made the placement already with a surplus lines company. Alaska Statute does not allow a broker who was not involved in the transaction to file on behalf of another. The filing was included in the monthly report for April 2006.

There were no notifications to the insured either before or after binding. The affidavit of due diligence was signed by Patterson's surplus lines broker even though she was not involved in the due diligence check.

This policy is for a risk that meets the definition of wet marine and transportation per AS 21.34.900(9) as it is for P&I of a watercraft. This policy should have been filed on an ~~Unauthorized Insurer's Annual Tax Report per AS 24.33.055 with tax calculated at 75% and no filing fee.~~

Recommendation: It is recommended that Patterson Insurance Brokers not accept the responsibility of making a filing on behalf of another firm or individual not holding an Alaska surplus lines broker license if they were not involved in the transaction.

Patterson Insurance Brokers Inc response to initial exception report June 27, 2007: We will no longer provide any courtesy filing to anyone. We will refund the \$44.25 to the insured when received from the State.

Division response: It is further recommended that the broker not sign an affidavit of due diligence for which they were not a part of the diligence check.

SUMMARY AND SUBSEQUENT EVENTS

Summary

This was a premium tax audit of Patterson Insurance Brokers Inc. The auditor tested 12 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 Patterson Insurance Brokers Inc's management and staff.

Several significant issues did arise during the audit.

- 1) The courtesy filing accepted from a non-licensed producer does not meet statute requirements and resulted in the insured not receiving all the required notifications that the insurance company was not authorized in Alaska and should the company become insolvent, there is no relief from the Alaska Guaranty Association.
- 2) The required notification to the insureds 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 any file.

Re-Audit

In closing, while the auditor found problems with the notification requirements, 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 Patterson Insurance Brokers Inc be put into the premium tax audit cycle with all other brokers.

Submitted by:
Rebecca Nesheim
Tax Auditor

Affidavit

Patterson Insurance Brokers Inc
As of December 31, 2006
TA 07-02

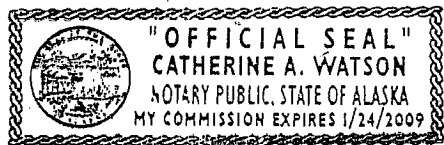
Juneau, Alaska)
August 13, 2007)
State of Alaska) ss.
First Judicial District)

I, being duly sworn, do verify that the report of premium tax audit as of December 31, 2006 of
Patterson Insurance Brokers Inc is true to the best of my knowledge and belief.

Rebecca Nesheim

Rebecca Nesheim
Tax Auditor

SUBSCRIBED and SWORN to before me this 13th day of August, 2007



Cecilia

Notary Public in and for Alaska

My Commission Expires 1/24/2009