

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 09-03)
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 09-03) has been transmitted to Mike 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

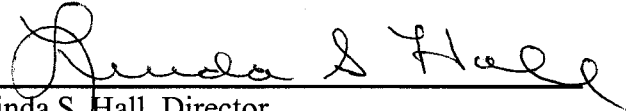
IT IS ORDERED

1. Pursuant to AS 21.06.150(b)(1), the audit report of Swett & Crawford Corporation (TA 09-03) 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 Jan 20, 2010.

Dated this 20th day of JANUARY, 2010 at Juneau, Alaska.



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

PREMIUM TAX AUDIT OF

**Swett & Crawford Corporation
Seattle, WA**

TA 09-03

As of December 31, 2008

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



**FINAL REPORT:
January 20, 2010**

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DEPARTMENT OF
COMMERCE
COMMUNITY AND
ECONOMIC DEVELOPMENT

Division of Insurance

Sean Parnell, Governor
Emil Notti, Commissioner
Linda S. Hall, Director

January 20, 2010

Linda S. Hall, CPCU
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 September 15, 2009 through September 17, 2009, 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 second premium tax audit of the broker conducted by the Alaska Division of Insurance. The first premium tax audit was completed on January 23, 2007.

Subject Matters Audited

The broker is an Alaska licensed surplus lines broker based in Seattle, WA. The division included in the current audit a review of the statutory compliance with monthly filings, premium taxes paid, and filing fees paid, for accuracy and timeliness as well as required due diligence and disclosures and notifications to the insured.

Time Frame

The audit covered the broker's surplus lines business for the two years of January 1, 2007 through December 31, 2008.

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METHODOLOGY

The tax auditor sent the call letter and initial data requests to Swett & Crawford Corporation's office in Seattle, WA. A list of all Alaska business transactions with nonadmitted insurers was requested for the period to be audited. Swett & Crawford Corporation complied on a timely basis with the initial data requests. The number of policies and endorsements written during the audit period was 692, 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 reports and accompanying forms were filed on time.
 - 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) Verified the multi-state allocation form was filed when appropriate.
- 4) If the placement is a multi-state placement, check the calculation and reasonableness of the methodology to allocate.
 - i) Audit steps taken:
 - (1) Verified the allocation of premium for each state is reasonable and the calculation is accurate.
- 5) Verify quarterly and annual premium tax reports were filed on time.
 - i) Audit steps taken:
 - (1) Confirmed when the quarterly and annual premium tax reports were mailed to the 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 on time 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.

The next five tests are new for the premium tax audit process:

- 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 evidence of insurance to ensure the broker's name, license number, and stamp required by statute AS 21.34.100(a) & (e) is present and legible.
- 11) Review notifications for use of non-admitted insurer
 - i) Audit steps taken:
 - (1) Reviewed the correspondence and other documentation in the files to find a copy of the notification sent to the insured that meets the requirement in AS 21.34.110
- 12) Confirm coverage is placed with an eligible non-admitted insurer
 - i) Audit steps taken:
 - (1) Reviewed the white lists to ensure the company was eligible at the time of placement
- 13) Review notice regarding nonrenewal and premium increase
 - i) Audit steps taken:
 - (1) Verified in each file there was a policyholder notice regarding nonrenewal and premium increase included with the policy 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 on time
AS 21.34.080 and .170, 3 AAC 25.090 and .100

Comments: All 24 monthly reports were filed on time.

Result: Passed (error rate 0%)

2. Verify the accuracy of the premium calculation

AS 21.34.180

Comments: One policy had inspection fees of \$150 that were not included in the calculation of premium. The additional tax and fees on inspection fees are \$4.05 and \$1.50. The remaining policy premiums were accurate.

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

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

Recommendation: It is recommended that the broker enforce their written procedures to ensure all company fees are appropriately included in the premium calculation and broker fees are not included. A checklist used during the lifecycle of a policy could help prevent such errors.

Swett & Crawford response: Procedures have been implemented including a second individual for quality control of invoiced amounts and review and conformance. Written procedures provided.

3. Verify the accuracy of all monthly reports filed

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

Comments: The monthly reports as filed with the Division during the two year audit period still contain errors such as wrong insurance companies, wrong NAIC numbers, incorrect or missing policy type codes, transaction reports not matching with corresponding monthly premium report summaries, transactions filed in the wrong month, etc.

The following eight monthly reports had at least one of the above mentioned problems:

2007: September and December

2008: April, June, July, September, October, and November

One audit policy was not filed for which additional tax and fees are \$207.41 and \$76.82. One policy's transaction form and corresponding monthly summary reported the admitted company within the same group instead of the surplus lines company. One transaction was filed late as an additional transaction to a previously filed report.

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

Result: Failed (16 monthly reports passed & 8 failed, error rate 33%)

Recommendations: It is recommended the broker continue to enforce the written procedures for a second individual to review the monthly reports for accuracy. A checklist could be an effective tool to use. The written procedures should be revised to include a second accounting report be generated just before sending the monthly report to the Division to ensure all transactions invoiced in the subsequent month were identified and reported in the correct month.

Swett & Crawford response: Procedures have been implemented and reviewed with all staff.

4. Verify the multi-state placements are filed correctly

AS 21.34.180

Comments: Those policies that were multi-state were allocated in a reasonable manner based upon the information provided by the insured and the insurance company.

Result: Passed (error rate 0%)

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

AS 21.34.180, 3 AAC 21

Comments: The eight tax reports were filed on time.

Result: Passed (error rate 0%)

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

AS 21.34.180, 3 AAC 21

Comments: When the tax reports were originally filed, they were accurate based upon the monthly reports filed. The errors found during the audit in the accuracy of the premium amount and the monthly reports affected the tax reports.

Result: Passed (error rate 0%)

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

AS 21.34.180, 3 AAC 21

Comments: One partial payment for the 2007 annual tax payment was made a day late. A penalty was assessed and paid prior to the audit. All remaining tax payments were made on time and by ACH.

Results: Failed (7 payments passed & 1 failed, error rate 13%)

Recommendation: It is recommended the broker revise their written procedures to include due dates for all payments to ensure they are made on time. It would be in the best interest of the broker to make payment several days in advance so that if the amount was not correct, another payment could be made by the due date.

Swett & Crawford response: Written procedures have been amended and reviewed with all staff. These now include due dates for payment of state tax and filing fees in addition to payment being sent to the Division by the 25th of the month.

8. Verify tax and filing fees payments were made accurately

AS 21.34.180, 3 AAC 21

Comments: The accuracy of the tax and fee payments is based entirely on the accuracy of the monthly reports and the tax reports. During the audit, several inaccuracies were found in how the reports were created which in turn affected the accuracy of the tax and fee payments

Additional tax and fees due are \$211.46 and \$78.32 respectively. The Division requests the broker file the corrected monthly reports and pay the additional tax and fees now.

Swett & Crawford response: Accounts have been filed

Division response: Payment for the additional tax and fees were paid on November 24, 2009.

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

AS 21.34.020, 3 AAC 25.030 and .035

Comments: The broker uses the Affidavit of Due Diligence for documenting the diligent search efforts by the producing broker. Fifteen of the affidavits were not received prior to binding as confirmed by documentation in the files. One file did not contain any documentation the diligent search was performed. There were some emails from the office to agents saying “the affidavit needs to be completed and returned to our office within 7 days of binding,” which means the agents in the office are unaware of the prior to binding requirements.

Results: Failed (34 files passed & 16 failed, error rate 32%)

Recommendations: It is recommended that the broker revise their written procedures to ensure all diligent search efforts are documented prior to binding as required by Alaska statute and regulations. One solution is to include the Affidavit requirement for binding on the quote and the quote cover letter/fax instead of on the binder and to follow up on all missing documentation not received before the binding request is received. It is also recommended that additional training be provided to staff so all know the requirements.

Swett & Crawford response: Procedures have been amended and a checklist developed to ensure all diligent search documentation is received prior to incepting coverage. Employees have been given written documentation and we met for review and understanding. All staff signed a document indicating that they understood and will comply with procedures. Checklist has been developed for use by staff and will be generated along with all quotes in our system.

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

AS 21.34.100(e)

Comments: Out of 50 files, only two policy files had the correct wording in the stamp on the evidence of insurance as required in Alaska Statute (AS) 12.34.100(e). Neither premium bearing nor non-premium bearing endorsements or certificates of insurance were stamped although they are also considered evidence of insurance.

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

Recommendations: It is recommended that the broker revise their written procedures to include what evidence of insurance is required to be stamped. It is further recommended that the broker use the correct stamp language that was created on September 16, 2009 on all evidence of insurance.

Swett & Crawford response: Corrected and implemented on September 16, 2009. Procedures revised to include proper wording and post policy endorsements stamped accordingly. Policy disclosure rate was 100%; unfortunately wording varied slightly from the current version. Systems pulled the prior wording of the Alaska stamp when licensing was consolidated to our Los Angeles office.

11. Review notification for use of non-admitted insurer

AS 21.34.110

Comments: Seventeen policy files did not include any documentation the insured was notified the company writing the policy was a surplus lines company that 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 documentation the broker depends on for this notification currently is the service fee agreement they have the insured sign. However, when the fee is not charged to an insured, this document is not in the policy file.

Results: Failed (33 files passed & 17 failed, error rate 34%)

Recommendations: It is recommended that the broker create written procedures for what notification documentation will be maintained in the insured policy file. A checklist is a useful tool to ensure all elements of a lifecycle of a policy are documented. If a service fee will not be charged to the insured, another form of documentation must be used to show the insured was notified of the nature of the company writing the policy.

Swett & Crawford response: Written procedures amended to include separate notification when no fee is charged. Included on new checklist verification. Hindsight proves it was not prudent to rely on a combined notice for unrelated activities.

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

AS 21.34.050

Comments: All policies in the audit were placed with eligible companies.

Results: Passed (error rate 0%)

13. Review notice regarding nonrenewal and premium increase

3 AAC 25.050

Comments: Twelve policy files did not contain the Alaska Policyholder Notice. Seventeen policy files included the Notice but it was not the correct language required by the Director.

Results: Failed (21 files passed & 29 failed, error rate 58%)

Recommendations: It is recommended that the broker create written procedures to ensure all policies include the Alaska Policyholder Notice. A checklist is a useful tool to provide a guide for the broker to confirm the Notice is part of the policy. The insurance company must be contacted if the Notice is missing or not accurate.

Swett & Crawford response: Procedure amended and included on checklist

File Documentation:

Comments: Five policy files have quality control problems:

1. Two policy files have other insured's documents mixed in with the insured's computer record.
2. One policy file's computer header shows incorrect information regarding the effective date and this file also had a very mixed up policy with pages all out of order as well as duplicate copies of pages.
3. One policy file showed the insured was charged the premium tax and filing fee on the broker fee on the invoice.
4. One policy file's computer record showed the incorrect insurance company, which showed up on documents sent to the insured when in fact the information from the company showed the correct insurance company.

Recommendation: It is recommended that the broker ensure the computer information identifying each insured is accurate. There should be quality control set up within the office for all steps of a policy file from the initial creation of the record to the invoicing. It is important to review what was scanned or imported into policy files to ensure the right insured information is intact and all pages are in order.

Swett & Crawford response: 1) and 2) The files reviewed had been scanned during Swett & Crawford's transition into our current paperless environment. The initial scanning was performed by temporary employees. This was a new system and the entire process was new to the staff. On occasion documents were miss-filed and placed in incorrect production files. 3) Invoice had previously been corrected however was not placed within the electronic file. *The invoice was provided showing the reverse of the tax and fees to the insured.* 4) Procedures amended to include review and verification of market and paper written in our system.

SUMMARY AND SUBSEQUENT EVENTS

Summary

This was a follow-up to the premium tax audit of Swett & Crawford Corporation completed on January 23, 2007. The auditor tested 13 standards focusing on the broker's filing of monthly and annual tax reports and the subsequent payment of premium taxes and filing fees as well as due diligence and notification requirements for using a non- admitted insurer.

The compliance officer and staff were cooperative during the audit. The tax auditor appreciated this attitude.

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

- 1) The Report of Surplus Lines Transaction forms received by the Alaska Division of Insurance occasionally contain manual changes to premium by the Branch Administrative Manager, which indicates those entering information in the computer system are still not coding fees correctly. A total of 37 premiums were corrected on the 24 monthly reports by the Manager prior to filing the forms with the Division. Training for those entering data in the computer would be an important step to ensuring the quality of the information in the insured's records.
- 2) One policy transaction was not filed with the Alaska Division of Insurance, which shows the procedures implemented after the prior audit are not as effective as they should be.
- 3) The documentation of the diligent search of the admitted market was considerably worse in this re-audit than the initial audit of Swett & Crawford Corporation. The response from the prior audit was "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." Yet there is evidence the broker continues to be lax in their procedures.
- 4) The notification to the insured regarding the surplus lines insurance company was still not available in 34% of the policy files. It is imperative the insured understands the limitations when their coverage is placed in the surplus lines market and the only way to ensure the insured is notified is for the broker to maintain documentation of this notification.
- 5) The required stamp used on all evidence of insurance was not the language required by statute.
- 6) When 10% of the insured's policy files contain incorrect information which was either manually typed in or scanned/imported into the file, there is a major quality control issue that must be resolved by the broker.

Re-Audit

In closing, the auditor's recommended actions should help the broker correct the problems encountered. It is recommended that Swett & Crawford Corporation be re-audited in 2011 to ascertain compliance.

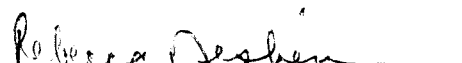
Submitted by:
Rebecca Nesheim
Tax Auditor

Affidavit

Swett & Crawford Corporation
As of December 31, 2008
TA 09-03

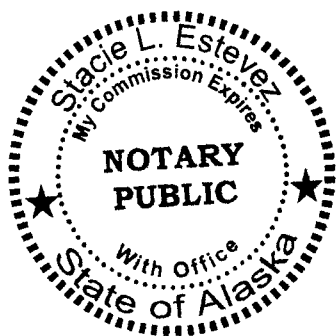
Juneau, Alaska)
January 20, 2010)
State of Alaska) ss.
First Judicial District)

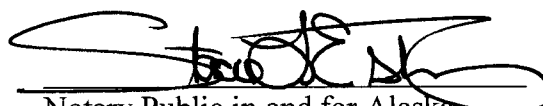
I, being duly sworn, do verify that the report of premium tax audit as of December 31, 2008 of Swett & Crawford Corporation is true to the best of my knowledge and belief.



Rebecca Nesheim
Tax Auditor

SUBSCRIBED and SWORN to before me this 20th day of January, 2010





Notary Public in and for Alaska

My Commission Expires with office