



THE STATE OF FLORIDA

OFFICE OF INSURANCE REGULATION MARKET INVESTIGATIONS

TARGET MARKET CONDUCT FINAL EXAMINATION REPORT

OF

CITIZENS PROPERTY INSURANCE CORPORATION

October 8, 2010

NAIC COMPANY CODE: 10064

EXAMINATION RESOURCES, LLC

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PURPOSE AND SCOPE OF EXAMINATION

Examination Resources, LLC and the Office of Insurance Regulation (Office), Market Investigations, performed a market conduct examination of Citizens Property Insurance Corporation (Citizens or the Company) pursuant to Section 624.3161, Florida Statutes. The scope period of this examination was July 1, 2008 through June 30, 2010. The onsite examination began July 26, 2010 and ended October 8, 2010.

The purpose of this market conduct examination was to determine Citizens' compliance with Florida Statutes, the Florida Administrative Code, its plan of operation, and its internal operational procedures. Pursuant to Section 627.351(6)(k), Florida Statutes, this report is being prepared for submission to the President of the Senate and the Speaker of the House of Representatives of the Florida Legislature.

An operational review of current systems and controls was performed including evaluation of Citizens' processes for corporate records, general operations, accounting, investments, Office of Internal Audit, information systems, depopulation, agent practices, complaint handling, underwriting and rating, cancellations/non-renewals, general claims excluding sinkholes, sinkhole claims review, reserves, reinsurance, anti-fraud plan, legislative changes, procurements, and pending litigation.

During the planning and review phases of the examination, Citizens provided documentation on its internal controls. Included with this information were the two financial audit reports completed in 2008 and 2009 by the Certified Public Accounting firm of Carr, Riggs & Ingram, LLC, who performed detailed testing of internal controls. This examination incorporated the extensive testing of internal controls performed by the Company's Office of Internal Audit and by Carr, Riggs & Ingram, LLC.

Citizens' records were examined at its home office, located at 101 North Monroe Street, Suite 1000, Tallahassee, Florida. The Citizens' Information Systems review was completed at the Company's computer facilities located in Tallahassee, Jacksonville and Tampa, Florida. Documentation utilized in this report was provided by the Company, the independent auditors, the Office of Internal Audit, and other external sources.

The Report is based upon information obtained during the examination, additional research conducted by the Office, and additional information provided by the Company. The files examined were selected systematically from data files provided by the Company using the Audit Command Language software (ACL) to select the file samples randomly. Each finding by the Office was reviewed and given due consideration by Citizens. Procedures and conduct of the examination were in accordance with the *Market Conduct Examiner's Handbook*, and the *Financial Condition Examiners Handbook* produced by the National Association of Insurance Commissioners.

OPERATIONS REVIEW

CORPORATE RECORDS

Citizens was established on August 1, 2002, pursuant to Section 627.351(6), Florida Statutes, as amended in 2002 by Senate Bill 1418 and House Bill 385 (the Act), to provide certain residential property and casualty insurance coverage to qualified risks in the state of Florida. The intent of the legislation was that property insurance be provided through Citizens to applicants who are unable to procure insurance through the voluntary market. Citizens was formed from a combination of the Florida Residential Property and Casualty Joint Underwriting Association and the Florida Windstorm Underwriting Association. The Florida Residential Property and Casualty Joint Underwriting Association was renamed Citizens Property Insurance Corporation. The rights, obligations, assets, liabilities and all insurance policies under the Florida Windstorm Underwriting Association were transferred to Citizens. Citizens is not required to have a certificate of authority issued by the Office.

Citizens operates under the supervision of an eight member Board of Governors (Board) pursuant to a Plan of Operation. Florida's Governor, Chief Financial Officer of the state of Florida, Speaker of the House, and President of the Senate each appoint two individuals as members of the Board for three year terms. Each Board member serves at the pleasure of his or her appointing officer.

The examination testing procedures included:

- Reviewing the Plan of Operation;
- Reviewing Board and Committee Meeting Minutes;
- Reviewing the procedure for management's timely filing of the financial interest statements with the Commission of Ethics;
- Reviewing reports of both external and internal audits that were performed during the scope of the examination;
- Reviewing the Exhibit B – Examination Planning Questionnaire from the NAIC *Financial Condition Examiners Handbook* completed by Citizens at the request of the examiners;
- Reviewing Citizens' Organizational Chart; and,
- Reviewing the prior examination findings for completed remediation.

The prior examination noted a finding that the Company could not document that the 2008 financial interest disclosures were filed timely as required by Section(s) 112.3145 and 627.351(6)(d)3, Florida Statutes. A review of the present process noted the Company has made a correction by implementing a monitoring control to ensure all financial interest disclosure statements are properly filed. Additionally, verification was made that all of the 2009 financial interest disclosure statements were filed as required.

GENERAL OPERATIONS

This section addresses areas not included in the Accounting or Investment Sections of the examination report. The examination testing procedures included:

- Reviewing deficit assessments; and,
- Reviewing the process of maintaining proper business insurance.

During the examination planning phase, the Company noted that it did not incur any deficit assessments within the period under examination.

The Company has adequate controls and utilizes the manager of Risk & Safety in its Enterprise Risk Management group to monitor and maintain various forms of business insurance for the Company. The types of insurance include the Company's fidelity bond insurance, Employee Benefits Liability insurance, Workers' Compensation insurance, and other insurance.

ACCOUNTING

A review of Citizens' accounting processes and procedures was completed for the period under examination. The testing included the following procedures:

- Verification that the Company's trial balance agreed to the filed Annual Statement at 12/31/2009;
- Verification that the filed 2009 Annual Statement agreed to the audited financial statements;
- Verification that the Company completed all filings as required by the Florida Office of Insurance Regulation (Office) and the State of Florida Department of Financial Services; and,
- Review of the processes and procedures for financial reporting.

As required by the Office, Citizens had an annual audit completed on its financial statements for the reporting periods ending December 31, 2008 and 2009, respectively. The audits were performed by the accounting firm of Carr, Riggs and Ingram, LLC, who issued unqualified audit reports for 2008 and 2009.

In 2010, the Company issued a request for proposal to conduct the next annual audit. Johnson Lambert & Company, LLP was awarded the engagement, with the approval of the Audit Committee and Board of Governors, to perform the annual audit beginning with the period ending December 31, 2010.

Testing concluded all filings were completed timely and accurately. A review of the Company's financial reporting process and procedures did not identify any material weaknesses in controls over the financial reporting process.

INVESTMENTS

A detailed review of the investment processes was completed for the period under examination. The review included the following procedures:

- Review of Citizens' investment guidelines;
- Comparison of its investment guidelines to its plan of operation;
- Review of the processes and procedures for investments;
- Review of the CPA's work papers relative to treasury, other than temporary impairments, and reconciliations;
- Review of the custodian agreements and corresponding SAS 70 auditing standard reports;
- Verification of the accuracy of investments reported; and,
- Review of the Office of Internal Audit's audits completed in the areas of investments.

In 2009, Citizens implemented revised investment guidelines. The revised guidelines were separated into two parts: Investment Policy for Operating Funds and Taxable Pre-Event Bonds Proceeds, and Investment Policy for Tax Exempt Pre-Event Bonds Proceeds. The revised guidelines maintain a conservative nature in their investment strategies.

Section 21 of The Plan of Operation addresses Citizens' investments. There are two guidelines prescribed by the Plan of Operation. The first guideline provides that Citizens "...shall adopt an investment policy and procedures that are consistent with Florida Statutes, prudent financial management, and restrictions found in applicable investment documents." The second guideline states that the assets of Citizens "...may be invested and managed by the State Board of Administration."

A detailed review of the investment processes and procedures was completed during the examination. The review included obtaining documentation from the Company, the Office of Internal Audit, and the external auditors. The areas reviewed were:

- Treasury: Treasury management, bank reconciliations, accounts payable, cash and cash disbursements, and payment services;
- Investments: Investment accounting, account reconciliation, investment policies and procedures, and financial reporting;
- SAS 70 auditing standard Review: Finance SAS 70 auditing standard review procedures and SAS 70 auditing standard checklist;
- Reconciliations: Walkthroughs and process narratives for the various bank and investment reconciliations; and,
- Management Reporting: Process narratives and process maps for the monthly reporting to the Board of Governors.

Citizens has adequate documentation of controls for the cash and investments processes.

The documentation includes narratives, process maps, and walkthroughs. There were no material gaps or weaknesses in controls identified by either the External Auditor or the Office of Internal Audit.

The Company has a process in place for monthly review of investments by the investment manager. The investment manager advises the CFO and the Finance and Investment Committee on securities that display any potential problems. The External Auditor determined through its testing that the estimate of fair value for those securities not trading are reasonable and have been consistently applied.

The Company provided copies of all custodial agreements. Each custodial agreement was verified to have a corresponding SAS 70 auditing standard report, which is an internationally recognized auditing standard for service organizations that was developed by the American Institute of Certified Public Accountants. The Company has implemented a SAS 70 auditing standard review policy, including the use of SAS 70 auditing standard review checklists. The SAS 70 auditing standard review checklists sampled were completed satisfactorily.

The External Auditors performed detailed testing on cash and investment accounts. No exceptions were noted by either the Auditor or the Examiner.

Citizens has demonstrated adequate controls over its investment processes.

OFFICE OF INTERNAL AUDIT

In May 2006, Senate Bill 1980 required Citizens to establish the Office of Internal Audit to coordinate and be responsible for the activities that promote accountability, integrity, and efficiency to the policyholders and taxpayers of the state of Florida. The Office of Internal Audit experienced significant growth and development in 2008 and 2009. The Office of Internal Audit focused on building a sustainable internal audit program including development of the department's foundation; establishing policies and procedures; participating in corporate compliance initiatives; formalizing the audit process; and conducting internal audits, management advisory services, and internal investigations.

In 2010, the Office of Internal Audit completed a self-assessment of the internal audit process, and contracted with Crowe Horwath, LLP to conduct an independent review of the Office of Internal Audit in accordance with the International Standards for the Professional Practice of Internal Auditing. The results of the independent review, issued in November 2010, indicated that the Office of Internal Audit generally conforms to the International Standards for the Professional Practice of Internal Auditing and the Institute of Internal Auditors (IIA) Code of Ethics. "Generally conforms" is the highest rating awarded by the IIA in connection with a quality assessment review.

During the examination, a review was completed for the following areas of the Office of Internal Audit:

- Reviewing the Internal Audit Charter;
- Reviewing the Office of Internal Audit's Policies and Procedures;
- Reviewing the Office of Internal Audit's Annual Report;
- Reviewing Management Reporting of Office of Internal Audit's activities; and,
- Reviewing the Office of Internal Audit's Open Items process.

The Office of Internal Audit established an Internal Audit Charter outlining the Office of Internal Audit's key objectives, such as mission statement, independence and objectivity, scope, authority, responsibilities, periodic assessment, and standards of audit practice. The Audit Committee and Board of Governors approved the Charter in March 2010.

The Office of Internal Audit implemented the Office of Internal Audit's Policies and Procedures for the department, which was approved by Citizens' Executive Director in March 2010.

Florida Statutes require the Chief of Internal Audit to submit an annual report that summarizes the activities of the Office of Internal Audit during the preceding fiscal year. The report includes:

- An evaluation of the effectiveness of Citizens' internal controls;
- Recommendations for corrective action, if necessary;
- Summaries of audits, reviews and investigations conducted by the Office; and,
- Other information as necessary.

The report is presented to the Board of Governors, the Executive Director, the members of the Financial Services Commission, the President of the Senate, and the Speaker of the House of Representatives.

The Chief of Internal Audit provided copies of the annual reports for 2008 and 2009, respectively.

The Office of Internal Audit conducted three internal audits during the scope period of the examination. The audits were in the areas of check and cash disbursements, treasury and investments, and payment services. All audits were classified as satisfactory. Although the Office of Internal Audit classified the audits as satisfactory, the Office of Internal Audit noted five issues in the three audits performed during the scope period of the examination. The Office of Internal Audit notes four of the issues are closed and one remains open as of June 30, 2010. According to the Office of Internal Audit open items list, the status of the remaining issue reviewed by the Office of Internal Audit for their June 30, 2010, report to the Audit Committee, the business unit is developing a security matrix for access to the General Ledger menu in the eWind system. Citizens reports that this item is now closed.

On a quarterly basis, the Office of Internal Audit prepares a Dashboard Status Report. The Report consists of an audit plan status, an open audit items status, and a detailed audit plan status report. The Report is issued to Management and the Audit Committee quarterly.

The Office of Internal Audit has a policy and procedures in place to monitor the open audit items. The policy was approved by the Board of Governors, the Audit Committee, and the Executive Director in June 2008. It is the responsibility of Management to remediate all open items. The Office of Internal Audit is responsible for communicating to Management and the Audit Committee the status and aging of the open items on a quarterly basis.

INFORMATION SYSTEMS

An examination of Citizens' Information Systems was performed in accordance with the guidelines and procedures set forth in the NAIC's *Financial Condition Examiners Handbook*, Exhibit C, Evaluation of Controls in Information Technology Planning Questionnaire, as well as walkthroughs of the processes.

Scope:

- Analyzing the major systems through which Citizens' data is processed;
- Observing and examining the data flowing through the system;
- Observing and examining the physical and system controls in place at the Tallahassee, Jacksonville, and Tampa, Florida computer facilities;
- Reviewing the Disaster Recovery Plan for all major system facilities as providers of the Citizens' Information Systems services;
- Reviewing changes to systems and procedures since the last exam;
- Confirming issues noted during the last exam; and,
- Confirming issues noted by the Office of Internal Audit.

The Company has 3 major data centers:

- The Primary Production data center is located in Jacksonville, Florida. The data center is in the Citizens Center Building, which is office space leased to Citizens. The facility is not tier rated for security.
 - Tier rating is a defined rating system by Uptime Institute which rates a data center regarding security and environmental controls including redundancy of equipment, power and communications capabilities as well as physical construction soundness and penetrability.
- The Disaster Recovery data center is located in Tampa, Florida. This site is not tier rated. The Tampa Disaster Recovery Center has a single generator which is a single point of failure.
- The Development Data Center is located in Tallahassee, Florida. This site is not tier rated.

Citizens maintains three major systems for the administration of policies:

- Electronic Policy Administration Systems (ePAS), which is the system for personal lines accounts, was located in Chantilly, Virginia, and was hosted by the package vendor, Insurance Management Services Office. It was subsequently moved to Raleigh, North Carolina, and was hosted by International Business Machines. The system has now been moved in-house and is being hosted and maintained by Citizens personnel.
- The Wind System and eWind system are AS400 based systems providing wind damage coverage, sometimes in conjunction with a primary property damage package that is not eligible for wind coverage, and sometimes as a wind only policy. All personal lines policies have been migrated to ePAS, and only commercial policies remain on the Wind System and on the AS400.
- The Commercial system, which includes all business entity policies multi-peril accounts, is hosted by Policy Management Systems Corporation in South Carolina. A SAS70 auditing standard report was reviewed for Policy Management Systems Corporation, now Electronic Data Systems, and no adverse findings were noted relating to the services provided for Citizens.

Claims are processed primarily through both the policy administration systems described above and the Claims Tracking System.

- The Claims Tracking System (CTS) was expanded during the last three years. It is now the major source of distributing claims to adjustors, controlling the work flow, and tracking the progress of claims as they flow through the system.
- Currently, the Company's Claims Tracking System has been in use since the 2004 events and was utilized for tracking claims activities and not for adjudication or documentation of claims. The primary initiative at the Company at this time is the CORE project, whereby the Company is moving toward CORE systems, a single claim system that is an actual adjudication system. ImageRight document management is utilized for the imaging of all policy and claims associated documents, including pictures, claim forms, policy applications, recommendations from field adjustors, etc.
- Global Policy Search is a home-grown system that allows Lynx (the provider for claims first notice of loss receipt), as well as in-house claims processors, to search for a policy across the three policy administration systems.

The financial system currently in use at Citizens is Pro Financials.

- The financial system previously in use at Citizens was Lawson which was replaced by Pro Financials, a Fiserve Product. While some issues occurred at implementation, the system is now in production and functioning well. Fiserv Pro Financials integrates with Power2Pay. See the section Check Printing for further explanation of Power2Pay functionality.
- Enterprise Portfolio System is utilized for investment management.

Systems Controls Evaluation

Systems controls were evaluated following the COBIT Framework as designated in the NAIC Handbook, Exhibit C Part 2.

The systems controls are much improved over the last review. An important addition is the oversight of the Office of Internal Audit, and the subsequent inclusion of Information Technology Auditors. The Office of Internal Audit performed several systems audits which were reviewed. The Company's responses to the exceptions and the addition of mitigating controls were reviewed and observed.

The following observations and recommendations were noted during the examination:

Physical Access to Data Centers

Observations:

1. During the site visit it was noted that the Disaster Recovery site in Tampa has only one generator. It is usual for a Disaster Recovery site to have n+1 of all essential equipment, "n" being the number required for functionality. Therefore, n+1 indicates one extra for redundancy. In the event one fails, the extra one can take over.
2. Access to the data center is via badge access only. The industry standard is two factor authentications. This would consist of two of the three primary authentication methods: something you know, such as a PIN number; something you have, such as a badge; and, something you are, such as a fingerprint or other biometric. Badge access only opens the opportunity for access to be attained by the acquisition of an authorized person's badge.
3. When entering the computer room it was noted there was no log-in sheet. Visitors must be accompanied by an authorized employee of Citizens; however, there should be a complete record of all persons who have entered the computer room. The authorized users are tracked by the badge entry, but visitors, vendors, and other employees who enter without badge access are not tracked.
4. There is an additional door which opens but has a deadbolt lock that stays locked all the time. There is no badge reader on this door. This is a control weakness. A person, such as a visitor, could unlock the deadbolt while in the data center and gain access through this door at a later time.
5. The access is managed by Sonitrol. The timing facility on the doors is available but is not enabled. This can introduce the opportunity for piggy-backing, where an unauthorized individual can enter behind an authorized individual. Additionally, the door can be propped open and equipment removed.

6. Data Center Access Card Administration was reviewed and exceptions were found: 3 Application Developers, 1 Underwriting person, and 1 EMC (Vendor) are on the access list. Application Developers should not have access to the data center. There is no apparent need for an Underwriting employee to have access to the data center. It is the primary policy for vendors not to have access other than accompanied or on a temporary badge approved by an authorized Citizens employee.

Recommendations:

1. It is recommended that the Tampa Data Center consider obtaining an additional generator as a backup to assure power to the DR site.

Company's Response: The Company agrees with this recommendation which will be incorporated in the planned Data Center realignment project.

2. It is recommended that access to all data centers be upgraded to require either entry of the PIN number or fingerprint to implement a two factor authentication.

Company's Response: The Company agrees that the current system allows for a single factor for access. There is however, a security camera monitoring system in place in all data centers that can validate entry. Adding an additional layer of authentication will be considered during the review and evaluation of a replacement security access control system in the near future.

3. It is recommended that a log-in sheet be placed by the door of each data center, and that all visitors be required to sign in with the date and time in the data center, and the date and time out of the data center. Additionally, the authorized employee should initial each entry.

Company's Response: This is a process that would need to be implemented and managed by appropriate IT personnel as an internal control measure. Facilities would support this process change and assist with implementation to improve access accountability. In addition, all visitors are required to sign-in at the main entrance/reception desk so there is a physical log of visitors/vendors but not specific to entry into any data center.

4. Badge access control should be added to this door.

Company's Response: The door in question exits to a secondary space that would have to be entered and another door unlocked before access could be gained. Intentions to breach security would be obvious by anyone escorting a contractor/visitor. At this time, Facilities believes the redundancy in doors/locks provides adequate security to minimize the risk of unauthorized entry as noted above. In addition, these specific doors are on the Security Guards post orders and are checked on a routine basis several times a day to ensure they are secure.

Adding a card reader to this door will be considered during the review and evaluation of a replacement security access control system in the near future.

5. It is recommended that this control be implemented in all data centers.

Company's Response: To ensure clarity this response will cover all locations. Sonitrol is the vendor that monitors and reports alarms. The programming and control access for the badges is handled in-house by Facilities Management. In Tallahassee and Tampa, there are door alarms on various external and data center doors that trigger a silent alarm notice within the system if a door is held open for an extended period of time. This is intended to reduce "piggy-backing" and receive notice if a door is propped open or has not closed properly. The data center doors in Jacksonville were not originally set up and designed to operate in this manner. Facilities Management has just received quotes on the necessary parts and labor to address this feature so as to be more consistent with other sites. A proposal will be submitted to management, that, if approved, will remedy this feature.

6. It is recommended that access to the computer rooms be reviewed, and that unnecessary access be terminated. Additionally, developers should not be granted access to the computer rooms. A periodic review of the people with access to the computer rooms should be a part of the recertification.

Company's Response: Currently, all access requests are received through a CAFM (Facilities primary software tracking system) which provides the necessary documentation to support all access requests. Access to Data Centers is not authorized without prior information technology approval. Facilities Management provides access reports to information technology on a non-routine basis for critical information technology and data center access doors. Facilities will review the most recent report with information technology to verify access and delete any inappropriate employee access as directed by information technology. If specific names are provided, it can be researched when, how and why the exceptions noted above occurred. Furthering the effort to ensure that information technology has a chance to review access reports on a frequent routine basis, monthly planned preventive maintenance requests have recently been set up in CAFM Explorer prompting Facilities Management to provide a report to information technology, so this activity will be recorded in CAFM Explorer. In the next few weeks, additional processes will be put in place to ensure consistency in how access is approved and the approval authority will be revised and re-defined to include a higher level of senior management approval.

Change Management

Observation

The Citizens' Information System's Specialist observed the production runs of the new check printing process. Several issues were observed that were not caught in quality assurance. This, in addition to the Internal Audit Report regarding the implementation of Pro Financials with issues pending, supports the finding that adequate testing is not being done to assure accurate performance in the production environment.

Recommendation

It is recommended that production environment testing controls be strengthened and that implementation of the product not be completed until successful testing has been accomplished.

Company's Response: After the date of the Pro Financials Internal Audit Report, which included the finding referenced in the above Observation, enhancements to the information technology Change Controls process were made through revisions to the information technology Change Management Policy. These enhancements incorporated controls that address the issues specified in the recommendation for this finding. The revised policy mandates that all changes made to any Citizens' information technology system must be documented through the Information Technology Department's Request for Change authorization system and that management approval must be obtained to ensure all changes are assessed, approved, implemented and reviewed in a controlled manner. In addition to this policy, guidance and leadership from the information technology's Steering Committee helps to ensure that application and system initiatives meet Citizens' Strategic Goals and Objectives, are aligned with enterprise business system requirements, and comply with the System Development Lifecycle and Project Management frameworks.

Disaster Recovery

The controls were found to be adequate with the improvements completed since the last examination.

Observation

All data centers for Citizens business are located in the state of Florida. Florida is prone to hurricanes, and therefore, a location outside of Florida should be considered. A repeat of a hurricane season with the wide ranging activity similar to that occurring in 2004 could potentially find Citizens without a functioning data center to serve its policyholders.

An inquiry was made to the Company with respect to the locations of the data centers in the event of an active hurricane season or major catastrophe. The Company responded

with the following statement, “Management agrees that the location of our data center facilities is a critical consideration. In response to a similar recommendation from the February 2009 Market Conduct Exam that an alternative site outside of Florida be considered, Citizens conducted a risk assessment for the geographical placement of a Disaster Recovery Site. The assessment supported management’s determination that since each site provides primary and disaster recovery capabilities, and that they are separated from one another by approximately 200 miles and in significantly different geographic locations of the state, it is highly unlikely that they would be unavailable at the same time. Management has determined this is an acceptable level of risk.

Claims Processing

An onsite visit was made to the Jacksonville Citizens office where daily claims processing was observed. A detailed walkthrough of the process was completed and documented. The walkthrough noted the changes and updates to daily claims processing.

The Company’s claims process has improved since the last examination. The Company has established controls over the claims process.

Check Printing

Check printing was observed in the Jacksonville facility. The checks were printed in the POINT building. The check printers are utilized only for this process. A staff member drives to the other building, and drives back with the checks after printing them. A guard escorts her to and from her car when she is in possession of the checks. The process was observed for all three administration system processes.

The check stock is stored in a locked drawer. The stock is taken out and checks printed. Numbers are recorded online, and the first and last numbers are verified to be as indicated by the software. The remaining check stock is replaced in the drawer. Different check stock is used for each system.

The check printing process was migrated to the Power2Pay system by Fiserv and implemented. This process was observed during the site visit. Several small glitches were discovered during the check run. These issues should have been caught during the testing phase and prior to implementation; however, the processors noted the issues, and developed manual workarounds. The process saves a lot of manual work in the printing, sorting, and merging of the backup that is included with each claim payment. The printing, however, takes a lot of time and must be monitored at all times. Therefore, a faster printer will be implemented at some time in the future.

The check printing process was found to be adequate and the controls sufficient.

Premium Processing

Underwriting, new applications, and premium processing are completed in the Jacksonville facility. This process was followed from the mailroom to the balancing of the payments.

The applications come in the mail and are imaged by mail room personnel. FedEx mail, and other special mail received, is recorded in a log, and then scanned into ImageRight. In addition to processing new business as indicated above, the Jacksonville branch also processes renewals and premium payments. Checks are separated from other mail through the use of a specific post office box and taken to the payment processing units. The processing unit has a machine to open the envelopes and remove the checks. Another machine endorses the checks and reads the barcode on the accompanying stub. The amounts are automatically entered into a file where they are reviewed and verified by processors until the amount of all checks balances to the accompanying batch total.

The processing of checks received for policies on the Policy Management Systems Corporation's system takes additional time due to the fact that each check must be manually recorded into the System.

The controls around the processes are adequate. All checks are processed on the day received except when a check cannot be matched up to an existing policy, i.e., a newly issued policy not yet in the system or an issue with matching the check to the policyholder if there is no payment stub. These cases may require additional research and may not be processed on the same day they are received.

The Premium Processing procedure was found to be adequate and the controls sufficient.

Section I – E-Commerce

The Citizens' Information System's Specialist requested a demonstration of the functionality of the Citizens web site. There is no functionality for policyholders or the general public other than static information and instruction on how to make a payment or report a claim – neither process can be executed via the website. Both agents and adjusters can log directly into ePAS utilizing an assigned user name and password. Additionally, the policy number must be provided to get into the policy record. The utilization of the web in this manner does not constitute E-Commerce to the degree that would satisfy the scoping note questions. Therefore, no further investigation or review of this section was conducted.

No significant issues were found for Section I – E-Commerce

The system infrastructure and processes at Citizens have greatly improved during and following the last examination. The Company made extensive financial expenditures to support that improvement as well as personnel changes and adjustments to the business model. The controls in place during this examination, with the exceptions noted above,

as well as completion of the projects in place to mitigate previously identified control weaknesses, are adequate to ensure the accuracy and completeness of the data.

DEPOPULATION

The guidelines for depopulation were established by the Florida Legislature and are contained in Section 627.3511, Florida Statutes. The intent of this legislation was to reduce the number of property owners who have insurance coverage through Citizens by encouraging new or existing insurance companies to takeout policies from Citizens. The following table shows the number of policies and amount of exposure removed from Citizens between January 1, 2003 and July 13, 2010:

Years	Policies Removed	Exposure Removed
2003	28,219	\$8,140,681,906
2004	158,416	\$30,663,076,480
2005	293,684	\$53,658,840,059
2006	67,853	\$15,637,589,369
2007	247,887	\$68,259,426,361
2008	385,084	\$106,870,490,165
2009	149,645	\$37,784,506,743
2010*	32,278	\$7,485,925,648
Totals	1,363,066	\$328,500,536,731

*Through July 13, 2010.

As noted in the above table Citizens' depopulation records indicate that the program declined significantly in 2009 and 2010 from its high point in 2008. The decline in depopulation is partly due to the liquidation of two companies in 2009, and policies non-renewed pursuant to consent orders.

The examination testing procedure included:

- Reviewing depopulation guidelines;
- Reviewing the process and procedures for depopulation;
- Reviewing the monitoring controls for the depopulation process;
- Reviewing lists of takeout companies; and,
- Reviewing Company records relating to a sample of takeout companies to verify compliance with depopulation guidelines, procedures, and Florida Statutes.

Citizens demonstrated adequate processes and controls to monitor the depopulation process.

AGENT PRACTICES

Citizens is a residual market program and does not employ a system to actively seek business. It focuses on communications, training, and compliance to facilitate its agents' customer service efforts. Citizens uses independent agents for its sales force and currently has approximately 8,500 agents authorized to write Citizens' policies. This is a decrease of 483 resident agents from the prior examination. Agents must hold an active 0220 or 2044 Florida Resident Agent's License, or an active 0920 or 9044 Non-Resident Agent's License. Agents must be in good standing with the Department of Financial Services and at the time of appointment have an affiliation with at least one authorized insurer writing new personal residential, commercial residential, or commercial non-residential property coverage in Florida pursuant to Section 627.351(6)(c)(14), Florida Statutes. Prior to appointment with Citizens, an agent must achieve a passing score on three technical testing modules, in addition to a compliance and general rules testing module that is unique to Citizens.

The examination testing procedure included:

- Reviewing the program for the utilization of agents, including the appointment and approval process;
- Reviewing the Office of Internal Audit's report on agent services;
- Reviewing the flow of operations of the agent appointment process for weaknesses in controls;
- Reviewing and documenting that agents in the underwriting policy review sample were both licensed and appointed by Citizens;
- Reviewing the Office of Internal Audit report on commission payments; and,
- Reviewing the prior examination findings for completed remediation.

The controls in place for the Agent Services processes were found to be adequate. Exceptions noted in the prior examination report and the Office of Internal Audit reports for agent services and commissions have been remediated.

COMPLAINTS REVIEW

Complaints originate from different sources: Florida Regulatory, Legislative, and Executive offices, as well as directly from consumers via mail or Citizens' website. Incoming complaints are recorded in the complaint log by an assistant and are then referred to a service specialist. If the specialist cannot resolve the issue, the specialist consults with a subject matter expert for handling (claims adjuster, underwriter, etc.). A written response is prepared by the Consumer Services Department and sent to the party making the inquiry. Complaint handling is documented in the complaint log and the appropriate policy administration system(s). A new complaint tracking system was implemented in 2009.

The following table shows the number of complaints received by Citizens by year during the scope of the examination:

Year	Number of Complaints
7/1/08 – 12/31/2008	1,829
2009	2,181
1/1/10 – 6/30/10	692
Totals	4,702

The examination testing procedures included:

- Reviewing Citizens’ complaint handling procedures;
- Reviewing the complaint log of all complaints received during the scope of the examination; and,
- Reviewing a randomly selected sample of 115 complaints from the total population of complaints during the scope of the examination. The sample included 72 Department of Financial Service complaints and 43 complaints received directly by the Company.

Examination Findings

There were 5 instances where deviations from written procedures were identified. They are as follows:

1. In 2 instances the Company failed to timely respond to Department of Financial Service’s complaints, in violation of Rule 69O-166.025, Florida Administrative Code.

Recommendation: Citizens should ensure responses to Department of Financial Services, Division of Consumer Services inquiries are timely.

Company’s Response: Both instances occurred prior to the implementation of the corrective measures that were taken after the prior examination.

2. In 1 instance the Company failed to reinstate a policy when the lien holder sent payment within 90 days in violation of Section 627.4133(5), Florida Statutes.

Recommendation: Citizens should ensure that policies are reinstated if the lien holder submits payment within 90 days.

Company’s Response: The Company agreed with the finding. Although we initially failed to reinstate the policy upon receiving payment from the mortgagee within 90 days of lapse, we did offer reinstatement, without lapse, upon return of the premium. A recent system enhancement has been implemented that will help to prevent a similar occurrence.

3. In 1 instance the Company cancelled a policy in error in violation of Section 627.4133, Florida Statutes. The policy was cancelled due to a system issue.

Recommendation: No further action necessary as Company has corrected the system issue.

Company's Response: The Company agreed with the finding. Although a payment plan was not initially established, the issue was corrected upon return of the refunded premium when the policy was reinstated with a payment plan set up. This incident was the result of a system issue, which was fixed in March 2010.

4. In 1 instance the Company issued a refund to an insured in error in violation of Rule 69O-167.001, Florida Administrative Code. The policy was cancelled and rewritten; therefore, money should have been transferred to the new policy.

Recommendation: This appears to be an isolated instance; therefore, no additional action is required.

Company's Response: The Company agreed with the finding. Money is only transferred on a limited basis through a manual process. Unfortunately, in this case, the refund was issued automatically before the manual process to transfer the funds to the rewritten policy could be completed. Such occurrences result in feedback to our business units which serve to improve our manual processes.

UNDERWRITING AND RATING REVIEW

As a residual market program, new applications to Citizens must include an agent certification acknowledging that any policy may be taken out, assumed or removed from Citizens, and may be replaced with a policy from an authorized insurer that may not offer identical coverage. New applications also include applicant affirmation acknowledging that the application may be selected and coverage issued by an authorized insurer other than Citizens, unless the premium for coverage from the authorized insurer is more than 15% greater than the premium for comparable coverage from Citizens or an authorized insurer is not willing to write the risk at its approved rates. Existing policyholders have the option of remaining with Citizens regardless of the premium differential with an authorized insurer. This is consistent with Florida Statutes, as well as Citizens' Plan of Operation and Underwriting Rules and Procedures. Citizens has implemented takeout procedures that are described in the depopulation section of this report.

The examination testing procedure included:

- Reviewing Citizens' underwriting rules, practices and rates utilized during the scope period;
- Reviewing Citizens' Plans of Operation during the scope period;

- Reviewing randomly selected files to determine eligibility, compliance with Citizens’ rule and rate filings, Florida Statutes, and Citizens’ Plan of Operation; and,
- Reviewing randomly selected files to verify compliance with prior examination and audit underwriting recommendations.

Inspection and Outreach Program

Citizens established an Inspection and Outreach Program to ensure wind mitigation credits are given on the basis of reports signed by licensed, qualified inspectors and submitted to Citizens. There were concerns that a substantial number of wind mitigation reports received may have inaccurately reported mitigation characteristics. Citizens selects properties to be re-inspected at no cost to policyholders. These re-inspections document and verify that the wind-resistive features satisfy the criteria required for the applied credits. Additionally, Citizens has instructed inspectors to evaluate any added features eligible for credits that may not already have been applied.

There were 3,380 inspections conducted during the scope of the examination. The inspections resulted in 1,725 properties losing the wind mitigation credit, 278 receiving a new credit, and 655 having the credit revised.

A sample of 20 inspections was selected to determine if the loss, revision or addition of the wind mitigation credit was appropriate. No errors were found.

Replacement Cost Estimator – Homeowners and Dwelling

Citizens’ ePAS (Marshall & Swift/Boeckh) replacement cost estimator is required to be accurately completed in the system. The risk must be insured to 100% insurance to value. “Insurance to value” means that the dwelling is insured to 100% of the full replacement cost. The requested coverage amount may not be less than 100% or greater than 125% of the replacement cost indicated on the Citizens replacement cost estimator. Citizens may accept a residential appraisal (no more than 1 year old) from a Florida licensed appraiser to determine the insured value.

At renewal, Coverage “A” Dwelling limit is adjusted annually for inflation as determined by the Marshall & Swift/Boeckh Index. The automatic increase in Coverage “A” does not apply to: (1) Condominium Unit Owners or (2) Tenant Named Insured policies.

The review showed a consistent use of the Replacement Cost Estimator.

Replacement Cost Estimator – Mobile Homeowners

Citizens requires the CIT-55 cost estimator to be accurately completed to establish the Coverage A “stated value” limit of liability for a residential mobile home. The requested Coverage A “stated value” limit of liability must not be less than 100% or greater than 125% of the stated value (replacement cost new less depreciation) on the CIT-55.

If the requested coverage amount does not comply with the requirements noted above, one of the following documents must be submitted with the application along with the CIT-55 to determine the “stated value” of the mobile home:

- A residential appraisal -- no more than 1 year old -- from a Florida licensed appraiser, or an appraiser acceptable to Citizens, which reflects the “Depreciated Value of Improvements”, **OR**
- A purchase agreement or bill of sale no more than one year old which reflects the purchase price less land value, **OR**
- A value report from a NADA Manufactured Housing Guide published within the last year.

At renewal, the coverage is not adjusted for depreciation unless requested by the policyholder.

Examination Findings:

One hundred and eighty-four (184) randomly selected files were reviewed. There were 42 instances where deviations from written procedures were identified. They are as follows:

1. In 19 instances the Company failed to use the correct protection class. Citizens uses Insurance Services Office's protection class manual in the development of the applicable rate. Although in most instances there was no premium effect, the protection class should be corrected to ensure proper classification of the risks.

Recommendation: Citizens should ensure the proper protection class is used.

Company's Response: The Company agreed with the findings and stated that it has corrected the protection classes of affected policies.

2. In 3 instances the Company failed to verify the year built of the insured property.

Recommendation: The Company has procedures to verify year built; however, underwriters should be reminded of this requirement.

Company's Response: The Company agreed with the findings.

3. In 2 instances the Company applied alarm credits without the required supporting documentation. Certain burglar alarms, fire alarms, and sprinkler systems in a dwelling will be recognized for a reduced premium; however, documentation supporting the existence of these was missing in the files.

Recommendation: The Company has procedures to verify existence of protective devices; however, underwriters should be reminded of this requirement.

Company's Response: The Company agreed with the findings, and stated that it would request supporting documentation and remove the credit if not provided by the insured.

4. In 3 instances the Company applied a wind mitigation credit without proof of existence of loss mitigation features. Citizens requires proof to substantiate the existence of loss mitigation features displayed in the Loss Mitigation Credit tables, except for roof shape which is verifiable via a photograph.

Recommendation: The Company has procedures to verify proof to substantiate the existence of loss mitigation features; however, underwriters should be reminded of this requirement.

Company's Response: The Company agreed with the findings.

5. In 4 instances the Company applied the incorrect Building Code Effectiveness Grading Schedule (BCEGS) code. The BCEGS develops a grade of "1" to "10" for a community based on the adequacy of its building code and the effectiveness of its enforcement of that code.

Recommendation: The Company should ensure the proper BCEGS code is used.

Company's Response: The Company agreed with the findings and has made corrections to affected policies.

6. In 3 instances the Company failed to obtain a signed waiver of flood insurance. Policyholders with properties in Special Flood Hazard Areas, as defined by the National Flood Insurance Program (NFIP), must maintain a flood policy unless the applicant or insured sign the "Election Not To Buy Separate Flood Insurance" (CIT-FW01) form.

Recommendation: The Company has procedures to verify receipt of the required form; however, underwriters should be reminded of this requirement.

Company's Response: The Company agreed with the findings.

7. In 1 instance there were no photographs in the file. Citizens requires two recent photographs (standard or digital); one photo angled to show the full front of the dwelling and one side, and the other photo angled to show the full rear of the dwelling and the other side.

Recommendation: The Company has procedures to verify receipt of required photographs; however, underwriters should be reminded of this requirement.

Company's Response: The Company agreed with the finding.

8. In 1 instance Citizens failed to follow its filed rates. Due to a system issue, policies excluding wind coverage, and that also excluded the optional Extended Coverage, were being charged a premium for the Extended Coverage when that coverage was not desired by the policyholder.

Recommendation: Citizens should provide the Office with a report stating the number of affected policyholders, the monetary effect of this issue, and estimated date the Company expects to return premium to affected policy holders.

Company's Response: The Company agreed with the finding, and stated that the issue was resolved, and was in the process of correcting policies that had been affected.

9. In 4 instances there was no documentation in the file that business was coming from insolvent insurers.

Recommendation: The Company should obtain necessary documents to verify the accuracy of the rates.

Company's Response: The Company captures insolvent insurer information on the application and verifies accuracy of rates by using prior information on the file and/or providing extended period of time for additional documentation to be received.

10. In 2 instances there was no documentation in the file that the business was produced through the Company's Automated Underwriting Process. The Company has established an Automated Underwriting Process for certain risks where no documentation is maintained by Citizens. Documentation is maintained by the agents.

Recommendation: The Company should maintain supporting documentation to ensure proper rates have been charged and underwriting guidelines have been followed.

Company's Response: The Company monitors the auto-approved process by performing audits on agent files to ensure supporting documentation is maintained, proper rates have been charged and underwriting guidelines have been followed.

Best Practice Recommendation:

As noted above, policy coverage amount for mobile homes is not adjusted for depreciation unless requested by the policyholder at renewal. This may present an over insured exposure after a policy has been in force a few years. It is recommended that the Company establish a procedure to periodically ensure the proper stated value is calculated.

CANCELLATIONS/NONRENEWALS REVIEW

The Company cancelled/nonrenewed 388,658 policies during the scope of the examination.

The examination testing procedure included:

- Reviewing randomly selected files to determine timely delivery of cancellations/nonrenewal notices, if specific reasons for termination were provided, issuance of timely refunds, compliance with Citizens' rule and rate filings, Florida Statutes, and Citizens' Plan of Operation.

Examination Findings:

Twenty-five (25) randomly selected files were reviewed. There was 1 instance where a deviation from written procedures was identified. The finding is described as follows:

1. In 1 instance the Company failed to timely issue a refund of an insured requested cancellation in violation of Rule 69O-167.001, Florida Administrative Code. Refunds should be sent within 15 working days.

Recommendation: As the Company was just one day late and this appears to be an isolated instance, no additional action is required.

Company Response: The Company agreed with the finding.

GENERAL CLAIMS REVIEW (EXCLUDING SINKHOLE)

Total Opened Claims:

7/1/08 – 12/31/08	1/1/09 to 12/31/09	1/1/10 to 6/30/10	Totals
26,863	43,446	20,965	91,274

Aging of Reported Claims in Open Status:

Number of Days Open	# of Claims	Percentage
0 – 29	2,084	24.90%
30 – 59	1,011	12.08%
60 – 89	500	5.97%
90 – 119	313	3.74%
>120*	4,462	53.31%
Totals	8,370	100%

Aging of Reported Claims in Closed Status:

Number of Days to Close	# of Claims	Percentage
0 – 29	35,638	42.99%
30 – 59	17,446	21.04%
60 – 89	8,798	10.61%
90 – 119	5,009	6.04%
>120*	16,013	19.32%
Totals	82,904	100%

Claims Payments:

7/1/08 – 12/31/08	1/1/09 to 12/31/09	1/1/10 to 6/30/10	Totals
17,597	24,951	9,238	51,786
\$239,589,169	\$330,327,555	\$100,148,055	\$670,064,779

Claims Closed Without Payment/Denied:

7/1/08 – 12/31/08	1/1/09 to 12/31/09	1/1/10 to 6/30/10	Totals
8,110	15,754	7,254	31,118

*In reviewing the aged claims statistics, it is noted that there is a high number of claims that were closed more than 120 days after being opened. Citizens reports the number of days on such claims by calculating the entire number of days from the date the claim was initiated to the final date it was closed. In many cases the claim was actually closed at some point during the counting period but it was necessary to reopen it for additional processing. Such additional work might be the result of additional claims made or, in some cases, the result of handling a trailing expense payment. Thus, the period of time counted for aged claim reporting may have included one or more time periods, during which the claim was actually considered closed.

The examination testing procedures included:

- Reviewing Citizens' claim handling procedures;
- Obtaining a list of the population of all claims reported during the scope period;
- Making random selections from the overall population for each of the groups of claims reviewed;
- Reviewing policy records for each claim selected to confirm that coverage was applicable; and,
- Reviewing the entire claim file for each selected claim to confirm that claims handling met all statutory requirements and complied with Citizens' internal procedures.

While the claims handling process involves many factors which could be evaluated, the primary focus of the review by the Office was on Citizens' effort to promptly handle claims by either paying all that is owed to the claimant, without overpayment of the claim, or by promptly declining payment for a valid reason.

Examination Findings

The general claims handling review by the Office consisted of a review of 165 non-specific claims (excluding sinkhole claims which were reviewed separately) selected randomly from the entire population of claims for homeowners, mobile homeowners, condominiums, and condominium associations, which were opened or reopened during the scope of the review. In 4 instances the randomly selected claim was handled together with a companion claim for the same policyholder. In those instances, both claims were reviewed increasing the total number of general claims reviewed to 169.

In 169 claim files reviewed, there were 34 instances where deviations from written procedures were identified. They are as follows:

1. There was 1 deviation from procedure related to the incorrect application of deductibles resulting in an overpayment of \$500. In that instance, the indemnification payment was incorrectly included in the loss adjustment expense such that the deductible was not applied when the payment was made.

Recommendation: Citizens should ensure that the correct deductible is applied in all claims.

Company's Response: The Company agreed with the finding. Proper application of deductibles is addressed in claims training programs for both staff and independent adjuster firms. Additionally, proper deductible application is reviewed by management in open and closed file reviews and by claims quality assurance in closed file audit reviews.

2. Section 627.7015, Florida Statutes, indicates that the insurer shall notify all first-party claimants of their right to participate in the mediation program. There were 3 instances found in which the claim file did not contain the required notification. The facts of the claims suggest that the policyholders should have been sent a notification of the right to seek mediation.

Recommendation: The mediation process was established to provide an informal forum for assisting parties electing this method of resolving their claim disputes. At any point, if an insured expresses concern regarding a claim settlement, Citizens should provide a notice of Right to Mediation in compliance with Section 627.7015, Florida Statutes.

Company's Response: The Company agreed with the finding and has implemented appropriate processes and file review expectations to ensure current and future compliance with the referenced statute.

3. Section 627.70121, Florida Statutes, indicates that a property insurer shall transmit claims payments that are owed to the primary policyholder only directly to the primary policyholder by check or other allowable payment method without requiring a dual endorsement from any mortgage holder or lien holder. There was

1 instance found in which a payment for contents items was made jointly payable to the policyholder and to the mortgage holder.

Recommendation: Citizens should review its procedures for payment of claims for contents items to ensure compliance with statutes.

Company's Response: The Company agreed with the finding and has instituted proper expectations to ensure compliance.

4. There were 6 instances noted in which the Company's claim file did not contain documentation and/or explanation sufficient to demonstrate the basis for the handling of the claim. The documentation and/or explanations were retained in the claim file maintained by the field adjuster but not in the Company's own claim file.

Recommendation: Citizens should review its policies related to maintaining "in house" those materials documenting the claims handling decisions to ensure that its own records contain all materials necessary to support those decisions.

Company's Response: The Company agreed with the finding and implemented a new process on September 9, 2009, targeted to improve Claims Settlement workflow and efficiency. In addition, new workflows were developed to support Field and MCM IA Operations wherein our Claims Support team prints and uploads Claims' letters to their respective claim file on behalf of the adjuster.

Citizens' Quality Assurance and Training Department in conjunction with Claims Management, conduct routine comprehensive claim file reviews to not only detect areas for improvement, but to assure quality claims handling and well documented claim files. In addition, the supervisors review all denials and partial denial letters prior to mailing.

Citizens has also used all efforts towards the creation of a sophisticated, advanced claims system called the CORE project which will enhance automation.

Citizens is continually evaluating and analyzing the Claims Operations procedures while instituting improvements, such as those outlined above, to uncover new areas for development.

5. Citizens' claim handling procedures require contact with the insured or claimant acknowledging the report of a claim within 2 days. There were 22 instances found in the general claims review of the 169 claim files in which contact was documented to have taken place more than 2 days after the report of the claim. However, in only 1 of those instances did the acknowledgement exceed the 14 day period permitted in Rule 69O-166.024, Florida Administrative Code. In some of the files reviewed there was insufficient documentation to clearly identify when the initial contact was made.

Recommendation: There was improvement in the Company’s contact since the previous examination. There should be continued focus on initial contacts to ensure that all claims are acknowledged within 2 days and that the file is properly documented regarding the contact as specified in Citizens’ procedures.

Company’s Response: The Company agreed with the finding. The claims operation has developed and implemented clear expectations for Staff and Independent Adjusting Firms, in conjunction with ongoing management review of open and closed files to ensure compliance with expectations.

The following table shows the specific results for the 169 claims reviewed:

Number of Days to Acknowledge				
0 - 2	3 - 14	15 - 45	46 - 90	Over 90
147	21	1	0	0

- There was 1 instance in which a disclosure of insurance coverage was requested under Section 627.4137, Florida Statutes. The claim file did not contain a response by the Company to the request.

Recommendation: The Company should review the process of handling such requests to ensure compliance with the statutes.

Company’s Response: The Company agreed with the finding and will incorporate appropriate training and management closed file review expectations to ensure compliance with Section 627.4137, Florida Statutes.

SINKHOLE CLAIMS REVIEW

Sinkhole Claims Reported:

7/1/08 – 12/31/08	1/1/09 to 12/31/09	1/1/10 to 6/30/10	Totals
503	1,559	1,040	3,202

Aging of Reported Claims in Open Status:

Number of Days Open	# of Claims	Percentage
0 – 29	166	9.01%
30 – 59	173	9.39%
60 – 89	187	10.15%
90 – 119	245	13.29%
>120	1,072	58.17%
Totals	1,843	100%

Aging of Reported Claims in Closed Status:

Number of Days to Close	# of Claims	Percentage
0 – 29	65	4.78%
30 – 59	54	3.97%
60 – 89	88	6.48%
90 – 119	140	10.30%
>120	1,008	75.15%
Totals	1,359	100%

Sinkhole Claims Payments:

	7/1/08 – 12/31/08	1/1/09 to 12/31/09	1/1/10 to 6/30/10	Totals
Number of claims	230	589	55 *	874
Indemnity Payments	\$25,616,563	\$40,141,894	\$1,586,832	\$67,345,290
Allocated Loss Expense	\$3,341,193	\$6,386,652	\$440,075	\$10,167,920

*As of 6/30/10, there were 906 open sinkhole claims for this period.

Sinkhole Claims CWP/Denied:

	7/1/08 – 12/31/08	1/1/09 to 12/31/09	1/1/10 to 6/30/10	Totals
Number of claims	238	579	79	896
Allocated Loss Expense	\$2,578,646	\$8,521,941	\$4,883,870	\$15,984,457

Top Five (5) Counties with Sinkhole Claims:

County	# of Claims	Percentage
Hernando	1,060	33%
Pasco	858	27%
Hillsborough	571	19%
Pinellas	289	9%
Miami-Dade	138	4%
Other counties	254	8%
Totals	3,170	100%

Number and Percentage of Sinkhole Claims Involving Public Adjusters:

7/1/08 – 12/31/08	1/1/09 to 12/31/09	1/1/10 to 6/30/10	Totals
88	196	201	485
17%	13%	18%	16%

There were 3,202 sinkhole claims reported during the scope of the examination. In reviewing sinkhole claims, 19 sinkhole claims were selected randomly from the entire

population of claims for homeowners, mobile homeowners, condominiums, and condominium associations, which were opened or reopened during the scope of the review. In 1 instance, the randomly selected claim was handled together with a companion claim for the same policyholder. In that instance, both claims were reviewed increasing the total number of sinkhole claims reviewed to 20. The number of sinkhole claims selected for review as compared to the entire claims review sample corresponds with the number of total sinkhole claims within the entire claims population, as compared to the total of the entire claims population.

Examination Findings

The findings from the review of sinkhole claims were as follows:

1. Section 627.707(3), Florida Statutes, requires that following the initial inspection of the insured premises, the insurer shall provide written notice to the policyholder disclosing certain specified information. The written notice was not found in 11 of the 20 claim files reviewed.

Recommendation: Citizens should review its procedures for handling of sinkhole claims to ensure compliance with statutes.

Company's Response: The Company believed that since an engineer had already been retained in 10 of the 11 instances that sending a notice as required under Section 627.707(3), F.S. would be a redundant notification. In light of this finding, Citizens will implement procedures to send notice even when an engineer has already been engaged.

Claims handling expense related to sinkhole claims:

For almost every sinkhole claim that is reported, it is necessary that the Company obtain a geohazard test. Such tests are performed by an outside expert in order to determine if sinkhole activity is present and if sinkhole coverage is applicable. The cost for such testing is the same whether sinkhole activity is present or not. Since such specialized tests are done by a somewhat limited group of companies comprised of engineers and geologists using specialized testing equipment, they are quite expensive and cause the claims expense for handling sinkhole claims to be significantly higher than the cost for handling general non-sinkhole claims. Of the 20 sinkhole claims reviewed, only 16 were completed with all allocated claims adjustment paid. The total cost for an expert paid under those 16 claims was \$168,445, or an average of \$10,527.85 per claim. In contrast, the total allocated claims cost paid for outside experts in 16 randomly selected general claims other than sinkhole claims was found to be \$12,109.83 or an average of \$756.86 per claim. The Company's internal unallocated claims expenses would ordinarily be essentially the same for both sinkhole claims as well as non-sinkhole claims.

An industry wide Sinkhole Data Call was recently conducted by the Office of Insurance Regulation and a report was prepared summarizing the findings. The effects related to sinkhole claims can be considered in greater detail with the additional review of this report. A copy of the report can be found at [http://www.floir.com/pdf/210_Sinkhole Data Call Report.pdf](http://www.floir.com/pdf/210_Sinkhole_Data_Call_Report.pdf).

Public Adjusters:

A public adjuster was involved in 50 of the 169 general claims reviewed. In 42 of those 50 general claims involving public adjusters, the public adjuster was retained *prior to* the claim being reported to the Company, and often the public adjuster was the party actually making the report of the claim to the Company. In 11 of the 19 sinkhole claims reviewed, the policyholder was represented by either a public adjuster or by an attorney.

The 50 claims for which there was representation by a public adjuster were distributed geographically as follows:

- | | |
|---------------------|-----------|
| • Miami Dade County | 35 claims |
| • Brevard county | 12 claims |
| • Palm Beach County | 2 claims |
| • Sarasota County | 1 claim |

RESERVES

A review of the actuarial reserving process was performed. The areas of examination included:

- Reviewing of Management Reporting;
- Reviewing of the Independent Actuarial Review;
- Reviewing of the Actuarial Process; and,
- Reviewing of the Office of Internal Audit of the Reserving & Loss Data Reporting Audit.

Citizens' management is informed of the actuarial processes through the established Actuarial and Underwriting Committee consisting of three members of the Board of Governors, one member of Management and three independent technical advisors. The committee meets on a regular basis, at least quarterly depending on need.

The Company has independent actuarial reviews completed annually. For the period ending December 31, 2009, the Board of Governors appointed an actuarial member of Insurance Services Office, Inc., to analyze the Company's reserves and prepare a Statement of Actuarial Opinion.

The Office of Internal Audit conducted an audit in the area of Reserves and Loss Data Reporting during the examination scope period. The audit reported a satisfactory rating with recommendations, and the business unit is in the process of completing these

recommendations. As of June 30, 2010, the Office of Internal Audit's Open Items Report indicates that 2 recommendations have been completed and are undergoing validation, and 3 recommendations are still in various stages of progress.

During the Reserving and Loss Data Reporting audit, the Office of Internal Audit completed a process map of the actuarial process.

The Company demonstrated adequate processes and controls to monitor and communicate the reserving and losses to the Board and Management.

REINSURANCE

Citizens utilized reinsurance coverage through the Florida Hurricane Catastrophe Fund (FHCF) during the period under examination. No private placement reinsurance was utilized. For the examination, the following areas were reviewed:

- Reviewing of the Reinsurance Program; and,
- Reviewing of the Reinsurance Authorizations.

Citizens is required by statute to make an effort to procure private catastrophe reinsurance at reasonable rates to cover its projected 100 year probable maximum loss as determined by the Board of Governors.

Management prepares an Executive Summary describing its analysis and conclusion on the types and amounts of reinsurance to purchase for the upcoming year. Management first presents the Executive Summary to the Finance and Investment Committee for recommended approval by the Board of Governors. Management then presents the Executive Summary to the Board of Governors for final approval in authorizing the purchase of reinsurance either by a full vote or through the consent items vote.

The Company's process for purchasing reinsurance has a high level of Management oversight and Board involvement in the decision making process.

For the period beginning June 1, 2009, Management recommended to the Board to approve the purchase of the additional Florida Hurricane Catastrophe Fund Temporary Increase in Coverage Limits. It was recommended not to purchase the private placement reinsurance due to increased costs and limited impact on assessments. For the period beginning June 1, 2010, Management recommended to purchase the mandatory Florida Hurricane Catastrophe Fund's coverage but not the Temporary Increase in Coverage Limits coverage. Management also recommended not purchasing private placement reinsurance primarily due to the inability to recoup the costs of private placement reinsurance.

ANTI-FRAUD PLAN

As part of the examination, a review was completed on Citizens' compliance with Section 626.9891, Florida Statutes, and Rule 69D-2.001-005, Florida Administrative Code, regarding Anti-Fraud processes. The examination included a review of the following areas:

- Verifying the Company has an established Anti-Fraud Policy and Procedure;
- Verifying the Company has a process map for Special Investigative Unit (SIU);
- Determining the Company has filed with the Division of Insurance Fraud a description of the Insurer Anti-fraud Investigative Unit;
- Reviewing the organizational structure for the Special Investigative Unit;
- Reviewing the criteria that the Special Investigative Unit has established and implemented to detect potentially fraudulent activity;
- Reviewing the criteria that the Special Investigative Unit has established and implemented to investigate suspected fraudulent activity;
- Reviewing the Special Investigative Unit method for reporting all suspected insurance fraud acts directly to the Fraud Division; and,
- Reviewing the information relating to the training of personnel on the detection and investigation of fraudulent acts.

The Company has an Anti-fraud Policy and Procedure, including a process map approved by the Manager of the Special Investigative Unit. The Company files a description of its anti-fraud plan, including any changes, with the Division of Insurance Fraud within the Department of Financial Services.

The Company has developed a defined Special Investigative Unit program including a Special Investigative Unit Business Plan. The Special Investigative Unit's Business Plan consists of performance metrics, investigative results, and fraud awareness training.

As noted in Citizens' anti-fraud plan, the Company and its Special Investigation Unit have established criteria that is used to detect suspicious or fraudulent activity during investigations relating to all types of insurance offered by Citizens, including personal residential, commercial residential, and wind-only endorsements.

The Company reports all suspected fraudulent insurance acts directly to the Division of Insurance Fraud using a digital reporting format or interface as provided at www.MyFloridaCFO.com/fraud. It is the practice of the Company that all such reports of suspected insurance fraud shall contain information that clearly defines and supports the allegation of suspicious activity. Also, it is the practice of the Company to maintain a record of suspected fraudulent claims activity, as well as record the date that suspected fraudulent activity is detected, and the date that reports of such suspected insurance fraud are sent directly to the Division of Fraud.

It is the practice of the Company to provide training related to the detection and investigation of fraudulent insurance acts for all personnel involved in anti-fraud related

efforts. Citizens provides both basic fraud awareness training, as well as continuing fraud awareness education and training to its adjusting staff in accordance with the Fraud Training and Regulations required by Section 626.989, Florida Statutes.

Citizens has demonstrated adequate processes and controls for its Anti-fraud Unit.

LEGISLATIVE CHANGES

For purposes of its tax-exempt status, Citizens is considered a political subdivision and an integral part of the state of Florida. As such, Citizens' operations are affected by the legislative process.

As part of the examination, a review was conducted of the processes and controls Citizens has in place to monitor and communicate the legislative changes affecting the Company's operations. The review included the following areas:

- Reviewing of the Legislative Guiding Principles; and,
- Reviewing of the process of managing legislative changes.

In 2009, the Board of Governors (Board) requested management to recommend a legislative document to communicate issues to the Legislative leadership that are applicable to Citizens. Management created the *2010 Legislative Guiding Principles*, which was approved by the Board in March 2010. The Principles will also provide direction to Citizens' legislative staff to ensure they continually act in the best interests of the Company. The *2010 Legislative Guiding Principles* include the following guidelines:

1. Achieve actuarially sound rates to reduce reliance on assessment.
2. Retain the current assessment structure.
3. Preserve the current assessment collection process.
4. Maintain the Corporation's ability to purchase reinsurance coverage from the Florida Hurricane Catastrophe Fund.
5. Support initiatives that further stabilize Florida's private insurance market and reduce Citizens' size.

The Company has several processes in place used to monitor and communicate legislative changes to the Board and Management. The processes include:

- The Policy Systems Steering Committee meets monthly to discuss the progress of the legislative process. The Policy Systems Steering Committee voting members include Executive and Senior leadership of the Company.
- The Director of Legislative and External Affairs developed and implemented a process of preparing a worksheet of all the legislative changes affecting the Company and presenting the worksheet to the Policy Systems Steering Committee.
- The Director of Legislative and External Affairs prepares an executive summary of the changes to be presented to the Board of Governors.

Citizens demonstrated adequate processes and controls to monitor and communicate the legislative changes to the Board and Management.

PROCUREMENTS

The areas of examination included:

- Reviewing the purchasing process;
- Reviewing the request for proposals process;
- Reviewing external communications of the proposal process;
- Reviewing a vendor's right to challenge a contract award; and,
- Reviewing the Board of Governors involvement in the process.

The Company maintains an updated copy of its purchasing process on its website. The last update to the policy was at the recommendation of the Procurement Review Committee in March 2010.

The Purchasing and General Services Department is responsible for administering Request for Proposals. The Purchasing and General Services Department has specific guidelines to follow for the competitive solicitation process on purchasing contracts. The guidelines include information provided by the business unit requesting the contract. This information includes:

- a. Scope of work;
- b. Performance criteria;
- c. Specific deliverables;
- d. Service level requirements; and,
- e. Any information necessary to explain the business need or intended purpose.

The Purchasing and General Services Department, with input from the requesting business unit, creates a process for the evaluation of vendor responses for the goods or services being procured and coordinates the receipt and evaluation of responses. The process includes the criteria to be evaluated and the method of evaluation.

The Purchasing and General Services Department issues all competitive solicitations using various methods of advertisement or communication designed to increase competition. The competitive solicitation award is made to the vendor whose proposal is determined to be of best value to Citizens. Competitive solicitations valued at \$100,000 or greater require Board of Governor's approval.

Located on the Company's website <https://www.citizensfla.com>, there is a link to the purchasing page(s) of the website. Included in this area are pages for the following areas of the purchasing process:

- Solicitations: Status of Request for Proposals Invitations to Negotiate and Invitations to Bid of either Open, Under Review, Award Notices or Closed.

- Current Notices: No legal notices were available at the time of the examination.
- Policies & Procedures: Several links including the Standard Terms and Conditions, the Purchasing Policy, Florida Statutes applicable to purchasing, and Citizens General Policy and Procedures.
- Vendor Registration: Web pages dedicated to electronically registering a vendor with the Company.
- Standard Purchasing Documents: A pdf folder with access to thirteen documents vendors may need to participate in a bid.

The Company provides communication of its procurement process and procedures to the general public.

Due to deficiencies discovered in the execution of the designed procurement process, during the third quarter of 2010, the Company collaborated with the Department of Financial Services to develop best practices for Citizens' competitive solicitation process.

This effort produced the following improvements to the process:

- Presenting to the Board of Governors a procurement policy that revises the broad exemption from competitive procurement.
- Implementation of additional training of staff in order to streamline the contracting and competitive bidding process.

The Chairman of the Board of Governors made an additional improvement to reconvene the Purchasing Policy Review Committee to determine if there are any additional changes needed to the process.

Citizens' Plan of Operation governs the appeal process that will be used in the event a vendor appeals the award of a contract by the Board. In support of this, the following paragraph is included in all competitive solicitations issued by Citizens' Purchasing and General Services Department:

APPEAL PROCESS: Appeals concerning Board action approving the procurement of services under this solicitation must be made in accordance with Section 25 of Citizens' Plan of Operation. The Board action shall be final unless within twenty-one days from the Board's approval of the procurement of services under this solicitation, Vendor delivers by certified mail, a request for relief or redress to the Executive Director of Citizens.

The appeal process is only available for procurements greater than \$100,000. Additionally, Citizens' complies with Chapter 286, Florida Statutes (Government in the Sunshine) by posting all notices of public meetings and procurement decisions on Citizens and the Department of Management Services' websites to provide greater visibility to the vendor community and the general public.

The Chairman of the Board of Governors authorized the creation of the Purchasing Policy Review Committee in December 2009, chaired by a representative of the Board of Governors, and included Citizens' CEO, CAO, and other key Citizens employees. Changes to the Purchasing Policy that were recommended and approved by the Board in March 2010 were:

- Emergency purchase approvals elevated to the Executive Director, and when practical, Chairman of the Board;
- All contracts of \$100,000 and greater require the approval of two members of the Executive Leadership Team;
- Approval levels for requisitions and contracts were reduced across the board for staff; and,
- All conflict of interests must be approved by the Ethics Officer in accordance with Citizens Code of Ethics Policy.

The Board of Governors is actively engaged in improving the procurement process.

PENDING LITIGATION

Citizens is involved in certain litigation and disputes incidental to its operations. In the opinion of Citizens management, after consultation with legal counsel, there are substantial defenses to such litigation and disputes, and any potential ultimate liability, in excess of the resulting reserves, will not have a material adverse effect on the financial condition of Citizens' operations.

Citizens has been informed that the Securities and Exchange Commission, the Florida Office of Financial Regulation, the state of New York Office of Attorney General Bureau of Investor Protection, and the Texas State Securities Board (Collectively, the "Agencies") have opened inquires or investigations of Citizens' purchase of its own auction rate securities in early 2008. Citizens is voluntarily cooperating with the Agencies and is of the belief that any action, if any, by one or more of the Agencies will not materially affect the financial condition of Citizens.

Citizens is also involved in other potentially significant litigation that due to the preliminary nature of this litigation, Citizens has not determined the effect, if any, on the financial condition or operating results. A summary of potentially significant litigation is as follows:

Poe & Associates, L.L.C. ("Associates") v. Citizens. This lawsuit relates to Citizens' June 2006, termination of its agent appointment agreement with Associates, which purportedly prevented Associates from being able to receive future commissions on policies that Citizens issued to former policyholders of insolvent insurance companies affiliated with Associates, and owned by Poe Financial Group, Inc. Associates is seeking significant damages, and its many claims include breach of contract, tortious interference, equal protection violations, and regulatory taking. This case has been underway for some time and is continuing.

Schirmer v. Citizens. This is a putative class action although the court has not certified the class. Potential class members are Citizens' policyholders who submitted wind damage claims. At issue is whether Citizens appropriately calculated and paid overhead and profit policy benefits.

Everhart, individually and on behalf of all others similarly situated v. Citizens. This is a putative class action although the court has not certified the class. Potential class members are Citizens' policyholders who submitted wind damage claims. At issue is whether Citizens appropriately calculated and paid ordinance and law policy benefits.

Citizens v San Perdido. Citizens appealed the trial court's ruling that Citizens does not have sovereign immunity for a cause of action of statutory bad faith pursuant to Section 624.155, Florida Statutes. The First District Court of Appeals recently certified this matter to the Florida Supreme Court for determination of jurisdictional issues. The Fifth District Court of Appeals in Citizens v Garfinkel, 25 So.3d 62 (Fla. Fifth District Court of Appeals 2009), previously held that Citizens is afforded statutory and sovereign immunity to a statutory bad faith action. Should the First District Court of Appeals be found to have jurisdiction, an opinion that conflicts with the Fifth District Court of Appeals will be resolved by the Florida Supreme Court.

Hernandez, et al. v Citizens, et al. This is a putative class action pending in federal court although Citizens has not yet been served and the court has not certified the class. Potential class members are Citizens' policyholders who have damages resulting from tainted dry wall. At issue is whether Citizens' policies for insurance provide coverage for damages claimed as a result of tainted dry wall.

EXAMINATION REPORT SUBMISSION

The courtesy and cooperation of the officers and employees of the Company during the examination are acknowledged.

Victor Negron, AIE, FLMI, IR, Todd Fatzinger, CFE, CIE, FLMI, Tammy Gavin ARe, MCM, Jenny Jeffers, CISA, AES, of Examination Resources, LLC along with staff from the Office participated in the examination.