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June 13, 2007

THE HONORABLE DONALD E. HINES,
PRESIDENT OF THE SENATE
THE HONORABLE JOE R. SALTER,
SPEAKER OF THE HOUSE OF REPRESENTATIVES

Dear Senator Hines and Representative Salter:

This report provides the results of our examination comparing the operations of Louisiana Citizens Property Insurance Corporation with the operations of residual market insurers in six other coastal states. This examination also compares statutes governing Louisiana Citizens with those governing the Florida Citizens Property Insurance Corporation, and it compares statutory requirements for Louisiana Citizens and private insurers in Louisiana. Also included is a comparison of governing board requirements for Louisiana Citizens, Florida Citizens, and the Louisiana Workers' Compensation Corporation.

I hope this report will benefit you in your legislative decision-making process.

Sincerely,

Steve J. Theriot, CPA
Legislative Auditor

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[LCPIC-COMP07]

Office of Legislative Auditor

Steve J. Theriot, CPA, Legislative Auditor

Louisiana Citizens Property Insurance Corporation - Comparisons to Similar Entities

Information Report (Third in a Series of Reports on Citizens)

June 2007 *Audit Control # 07101004*

HOW DOES LOUISIANA CITIZENS DIFFER FROM SIMILAR INSURERS?

HOW DOES LEGISLATION GOVERNING LOUISIANA CITIZENS DIFFER FROM THAT OF FLORIDA CITIZENS?

Conclusions

We compared various aspects of the Louisiana Citizens Property Insurance Corporation's (Citizens') operations with comparable residual market insurance plans in six other coastal states. The other states included in our review are Alabama, Florida, Mississippi, North Carolina, South Carolina, and Texas. We compared the plans in the following six areas:

1. Administration of services
2. Inclusion in the states' Comprehensive Annual Financial Report
3. Authority to levy assessments
4. Authority to recoup regular assessments
5. Noncompetitive vs. competitive rate requirement
6. Existence of a state catastrophe fund

Our comparisons show that Louisiana and Mississippi are the only two states that contract for their administrative services. All the other states hire their own in-house staff. In addition, all of the states have the authority to levy regular assessments, and only North Carolina does not allow its insurers to recoup those assessments. Only Louisiana, Florida, Mississippi, and South Carolina have authority to levy emergency assessments. In addition, only two states (Louisiana and Florida) include their plans in the states' Comprehensive Annual Financial Report (CAFR), and only Florida has a state catastrophe fund. All of the states except Florida require their plans to set rates higher than private market rates so that the plans do not compete with private insurers.

We also compared Louisiana's Citizens law to Florida's Citizens law. Florida law includes many controls over its Citizens corporation that Louisiana law does not include. These controls include, among other things, detailed audit and examination provisions and explicit employment and ethics requirements.

In addition, we reviewed the Louisiana insurance code as it applies to private insurers and Citizens. Although it is clear that certain provisions of the insurance code apply to Citizens, it is unclear in other areas. For instance, the law is not explicit as to whether Citizens is subject to certain examinations and investigations. In addition, the law does not explicitly state whether Citizens is subject to provisions dealing with penalties for failing to comply with the insurance code.

Finally, we compared the Louisiana Citizens law, the Louisiana Workers' Compensation Corporation (LWCC) law, and the Florida Citizens law as they relate to the corporations' governing boards. Both the LWCC law and the Florida Citizens law include important provisions that are not present in the Louisiana Citizens law. The Louisiana Citizens law lacks provisions in the following areas, which either the LWCC law and/or the Florida Citizens law include:

- Qualifications of board members
- Term limits
- Removal of board members
- Requirements that board must impose on the manager of the corporation
- Ethics requirements

Overview: Louisiana Citizens Property Insurance Corporation

The Louisiana Legislature created the Louisiana Citizens Property Insurance Corporation (Citizens) as a nonprofit corporation by Act 1133 of the 2003 Regular Legislative Session, which enacted Louisiana Revised Statute (R.S.) 22:1430. The corporation's purpose is to operate two residual market insurance plans previously established by the legislature and known as the Louisiana Insurance Underwriting Plan and the Louisiana Joint Reinsurance Plan. The legislation renames the old plans the Coastal Plan and the FAIR Plan, respectively, and designates the newly named plans as successors to the old plans. All insurers authorized[1] to write and engaged in writing property insurance in the state are required to participate in the Coastal and FAIR plans. Under state law, Citizens and the two plans are subject to examination by the Legislative Auditor.

[1] An authorized insurer is defined in state law as an insurer with a certificate of authority or license issued under provisions of the state insurance code.

According to the individual who was serving as Citizens' Chief Executive Officer when we initiated our work, the legislature modeled Citizens after the Citizens Property Insurance Corporation of Florida (Florida Citizens). The enabling legislation in Louisiana states that Citizens was created to provide fire, extended coverage, vandalism, malicious mischief, and homeowners insurance in the coastal and other areas of Louisiana to applicants who are entitled to, but are unable to, procure coverage through the voluntary (i.e., private) market. Citizens operates the FAIR and Coastal Plans, the insurance plans functioning exclusively as residual market mechanisms. That is, the legislature designed Citizens to be an insurer of last resort. Any person with an insurable interest in insurable property is entitled to apply to Citizens either directly or through a representative for coverage through the Coastal or FAIR Plan.

Administration of Services. Louisiana Citizens contracts its administrative services with the Property Insurance Association of Louisiana (PIAL). According to PIAL's 2006 budget, PIAL has 50 positions dedicated to Citizens and an additional 20 staff members who share Citizens responsibilities along with other PIAL-related duties.

Authority to Levy Assessments. State law authorizes Citizens to levy regular assessments against assessable insurers when Citizens faces a deficit in either the Coastal or FAIR Plan. The law defines assessable insurers ("insurers") as those authorized to write property insurance in Louisiana. Assessable insureds are the policyholders of the assessable insurers. State law further allows for emergency assessments if regular assessments are not sufficient to cover the deficit. For more information on assessments, see the Legislative Auditor's report titled *Louisiana Citizens Property Insurance Corporation - Assessments* dated December 2006.

Authority to Recoup Regular Assessments. After insurers pay Citizens the regular assessment, they may recoup all or a portion of this amount from their policyholders. State law authorizes insurers to add a surcharge to their policyholders' bills to recoup the assessment. The recoupment of regular assessments is optional. That is, insurers are not required to recoup the costs of regular assessments they incur.

Comprehensive Annual Financial Report. The CAFR outlines a state's financial condition. It is prepared in conformity with Generally Accepted Accounting Principles as prescribed by the Governmental Accounting Standards Board. Each state prepares a CAFR that presents the state's government-wide and governmental fund financial information including component units for which the state is financially accountable.

Because of the structure of Louisiana Citizens' board of directors, its oversight by the state legislature, and its fiscal dependence on the state, Citizens was included, for the first time, in the 2006 Louisiana CAFR. It was included as a major component unit of the state. R.S. 22:1430.2.B(1) states, in part, ". . . the debts, claims, obligations, and liabilities of the corporation shall not be considered to be a debt of the state or a pledge of its credit."

Noncompetitive Rates. Under state law, rates charged by Citizens must be at least 10% higher than the rates charged among the 10 insurers with the greatest total direct written premium in each parish for that line of business in the preceding year. State law further provides that Citizens' rates must be noncompetitive, actuarially justified, and adjusted annually. For more information on Citizens' rates, see the Legislative Auditor's performance audit report titled *Louisiana Citizens Property Insurance Corporation - Rate-Setting* dated May 2007.

Results of Examination

Differences in Operational Aspects of State Residual Market Insurance Plans

We compared various operational aspects of Louisiana Citizens with comparable residual market insurers in six other coastal states. The six other plans we selected for comparison are as follows:

- Alabama Insurance Underwriting Association (AIUA)
- Florida Citizens Property Insurance Corporation (Florida Citizens)
- Mississippi Windstorm Underwriting Association (MWUA)
- North Carolina Insurance Underwriting Association (NCIUA)
- South Carolina Wind and Hail Underwriting Association (SCWHUA)
- Texas Windstorm Insurance Association (TWIA)

We gathered information from the other states through review of their statutes and Web sites and through interviews of staff in those states. We compared how the plans hire administrative and management level staff (i.e., in-house versus contracted); whether the residual market plans are included in the states' CAFR; whether the plans have the authority to levy assessments; whether the assessed insurers are allowed to recoup regular assessments from policyholders; and whether the plans' rates are noncompetitive. We also identified which states have a state catastrophe fund. Our review yielded the following results.

Administration of Services. Louisiana Citizens (through the Property Insurance Association of Louisiana or PIAL) and MWUA (through the Mississippi State Rating Bureau) are the only plans that contract for administrative services. Some of Citizens' contracted employees divide their time between Citizens administration and other PIAL-related duties. On the contrary, the MWUA's contracted employees devote 100% of their time to MWUA administration. The other plans we reviewed (Florida Citizens, NCIUA, SCWHUA, and TWIA) do not outsource administrative services. SCWHUA employees perform work for the South

Carolina Property and Casualty Insurance Guaranty Association in addition to the association. Florida Citizens has its own full-time staff of approximately 1,100 employees.

Inclusion in CAFR. Louisiana and Florida are the only states in our review that include their residual market plans in their states' CAFR. Each state includes the Citizens corporations in the CAFR as a major component unit of the state. Fiscal year ended 2006 was the first time Louisiana included its Citizens corporation in its CAFR. Florida has included its Citizens corporation in its CAFR since 2003.

Authority to Levy Assessments. Each plan in our review has the authority to levy regular assessments on member insurers in the event of a deficit. The plans base the assessed amounts on the insurers' market share in the state, although assessments are based on different time frames. In Alabama, the AIUA assesses each insurer based on its proportion of premiums at the time of the deficit. The SCWHUA in South Carolina bases assessments on each insurer's proportion of premiums two years before the deficit. In the residual market plans in the four other states (Florida, Mississippi, North Carolina, and Texas), assessments are based on the previous year's premiums, as is the case in Louisiana.

If regular assessments are not sufficient to cover the deficit and the plan must borrow additional funds, Louisiana law further allows the Citizens corporation to levy emergency assessments to cover the borrowings. Florida Citizens, MWUA, and SCWHUA are the only other plans in our review that have authority to levy emergency assessments in this situation. Alabama, North Carolina, and Texas do not have statutory authority to levy emergency assessments, nor do their plans of operation contain provisions for emergency assessments.

Authority to Recoup Regular Assessments. Except for North Carolina, in each of the other states we reviewed, assessed insurers are allowed to recoup all or a portion of the regular assessments from their policyholders. The recoupment can be either direct (i.e., as a line item on the policyholder's bill, as in Florida and Louisiana) or indirect (i.e., by raising rates to include the assessment costs as in Alabama and South Carolina). Mississippi and Texas insurers also have the authority to recoup regular assessments indirectly. Mississippi recently passed legislation that allows the MWUA to place a premium surcharge on all policyholders and use the surcharge funds collected to reimburse assessable insurers. Texas insurers may receive a premium tax credit in the amount paid for regular assessments, but not more than 20% of the assessment per year for five years.

Noncompetitive vs. Competitive Rates. Florida Citizens is the only plan in our review that is not required to have noncompetitive rates. Previously, Florida did require its Citizens' rates to be noncompetitive. In January 2007, however, various legislative changes went into effect, one of which deleted the requirement for noncompetitive rates. In all of the other plans included in our review, the residual market insurers are required to set their rates higher than private market rates. Because insurers are not writing new policies in some areas, however, some residual market rates may have become competitive, as in Alabama, Mississippi, and South Carolina.

State Catastrophe Fund. The purpose of a state catastrophe fund is to protect insurers from excessive losses in the event of a catastrophe. Insurers pay into the fund, money in the fund is invested, and when a disaster occurs, the fund acts as reinsurance for the insurers. Louisiana does not have a catastrophe fund. State legislators proposed several bills to create one during the December 2006 Special Session of the Legislature, but none passed. Florida is the only state in our review that has a state catastrophe fund. Called the Florida Hurricane Catastrophe Fund, it was created in 1993 and is a state-run tax-exempt trust fund that operates as a catastrophe reinsurer for the state.

Exhibit 1 provides a summary of the differences in state plans we identified during our examination.

Exhibit 1
Summary of Operational Aspects of State Plans

State Residual Market Insurer	Plan is Administered In-House	Plan is Included in CAFR	Plan has Authority to Levy Regular/ Emergency Assessments	Plan has Authority to Recoup Regular Assessments	Plan Requires Noncompetitive Rates	State has Catastrophe Fund
Louisiana Citizens Property Insurance Corporation	NO	YES	YES/YES	YES (Directly)	YES	NO
Alabama Insurance Underwriting Association	YES	NO	YES/NO	YES (Indirectly by raising rates)	YES	NO
Florida Citizens Property Insurance Corporation	YES	YES	YES/YES	YES (Directly)	NO	YES
Mississippi Windstorm Underwriting Association	NO	NO	YES/YES	YES (Indirectly through surcharges on premiums)	YES	NO
North Carolina Insurance Underwriting Association	YES	NO	YES/NO	NO	YES	NO
South Carolina Wind and Hail Underwriting Association	YES	NO	YES/YES	YES (Indirectly through special rate filings)	YES	NO
Texas Windstorm Insurance Association	YES	NO	YES/NO	YES (Indirectly through tax credits)	YES	NO

Source: Created by legislative auditor's staff using states' revised statutes and Web sites and documents and data provided by residual market insurers.

Differences in Statutory Controls Over Louisiana Citizens vs. Florida Citizens

Because Louisiana Citizens was modeled after Florida Citizens, we performed a more in-depth comparison of the two states' statutes. Several of the statutory provisions governing Louisiana Citizens are similar to those governing Florida Citizens, including the declaration and purpose, immunity from liability, power and duties, assessable insureds, plan deficits and financing, and tax exemption. The Florida legislation, however, includes many internal controls that are not included in Louisiana's legislation. Following is a discussion of controls we identified that are present in Florida's law but not in Louisiana's.

Office of the Internal Auditor. The Florida law creates an Office of the Internal Auditor within its Citizens corporation. The board of governors appoints and supervises the internal auditor, who then reports back to the board. The internal auditor's duties are to:

(1) conduct audits, investigations, and management reviews relating to the programs and operations of Citizens;

(2) prevent and detect fraud, abuse, and mismanagement in the administration of programs and operations;

(3) submit audit reports, reviews, and investigative reports;

(4) keep the board informed of fraud, abuses, and internal control deficiencies; recommend corrective action; and report on progress made in implementing corrective action;

(5) report potential criminal violations to law enforcement agencies; and

(6) prepare an annual report evaluating the effectiveness of the internal controls; provide recommendations; and summarize audits, reviews, and investigations.

Market Conduct Examinations. The Florida law states that the corporation is subject to a comprehensive market conduct examination by the Office of Insurance Regulation every two years. The purpose of the examination is to determine Citizens' compliance with its plan of operation and internal operations procedures.

Operational Audits. The Florida law requires the Auditor General to conduct an operational audit of the Citizens corporation every three years. The audit must evaluate management's performance in administering laws, policies, and procedures governing the operations of the corporation.

Market Accountability Advisory Committee. The Florida law requires its Citizens corporation to have an 11-member Market Accountability Advisory Committee. The committee is required to report to the board of governors information regarding Citizens' rates as well as customer and agent service levels in relation to the private market. Specifically, the committee reports to the board to "assist the corporation in developing awareness of its rates and customer and agent service levels in relationship to the voluntary market insurers writing similar coverage." The committee must report at each board meeting on insurance market issues, customer service, claims processing, and matters relating to depopulation.

Special Divisions. The Florida law establishes divisions within its Citizens corporation to investigate possible fraudulent claims and to receive and respond to consumer complaints.

Senate Confirmation. The Florida law requires the state Senate to confirm any executive director appointed on or after July 1, 2006. The law also requires the board of governors to review and concur with the executive director on staff he or she hires.

Ethics Provisions. The Florida law requires background checks for senior management positions. In addition, the law requires all employees to sign and submit conflict of interest statements. The law further states that senior managers and board members are subject to the state code of ethics as well as to laws regarding public disclosure and reporting of financial interests. Finally, the law prohibits employees and board members from accepting gifts from contractors and potential contractors.

Legal Services. The Florida law requires its board of governors to determine whether it is more cost-effective and in the best interest of its Citizens corporation to use legal services provided by in-house attorneys rather than contracting with outside counsel.

Purchasing Provisions. The Florida law stipulates specific purchasing provisions that its Citizens corporation must follow.

Statutory Requirements for Louisiana Citizens vs. Private Market Insurers

We compared the Louisiana Citizens statutes with those governing private insurers in Louisiana. The Citizens statutes explicitly require the corporation to comply with certain provisions of the state insurance code. It is not always clear, though, whether Citizens must comply with other related provisions. A summary of the statutes in question is as follows:

Examinations and Investigations. According to R.S. 22:1430.15, Citizens must comply with the examination requirement in R.S. 22:1301. This statute says that the commissioner of insurance must examine all insurers at least once every five years. It is not clear, however, whether the other requirements following R.S. 22:1301 relating to examinations and investigations (i.e., R.S. 22:1302 through 1316) also apply to Citizens. These other statutes require, in part, that the commissioner conduct annual office reviews and examine annual statements, financial reports, results of insurance solvency standards testing, results of prior examinations and office reviews, management changes, consumer complaints, and other relevant information. The statutes also state that the commissioner may also examine each advisory organization and joint underwriting or joint reinsurance group, association, or organization as often as he or she deems necessary.

Miscellaneous Provisions. According to R.S. 22:1430.14, Citizens must comply with reporting requirements specified in R.S. 22:1451, which require all insurers to file annual and quarterly statements with the commissioner of insurance. The Citizens statutes do not specify, however, whether certain other requirements found in Title 22, Chapter 1, Part XXXI (Miscellaneous and Final Provisions) also apply to Citizens. Following are the provisions in question:

- <u>Fines for violations</u>. R.S. 22:1457 provides, in part, that the commissioner of insurance may levy a fine up to $1,000 per violation, not to exceed $100,000 per year, on any insurer who violates any provisions of the insurance code.

- <u>Written catastrophe plan</u>. R.S. 22:1479 states that every insurer writing any form of commercial or residential property insurance, automobile insurance, marine, or inland marine insurance shall maintain a written plan that describes how the insurer will respond to a catastrophe affecting its policyholders.

State law also includes certain provisions with which private market insurers must comply, but that do not explicitly apply to Citizens. That is, the Citizens law does not state whether Citizens must comply with these requirements. These provisions are as follows:

- <u>Claims requirements.</u> According to R.S. 22:658, insurers must pay claims within 30 days after receipt of proof of loss from policyholders.

- <u>Investments of domestic insurers</u>. R.S. 22:841 through 858 specifies investment provisions including securities in which insurers may invest, investment records insurers are required to keep, and other related investment requirements.

Controls Over Governing Boards of Louisiana Citizens, LWCC, and Florida Citizens

During interviews with representatives of the Department of Insurance, we learned that Louisiana Citizens is similar in structure to the LWCC, the state's residual market insurer for workers' compensation. Therefore, we compared statutory provisions for Louisiana Citizens' board of directors to LWCC's. We identified several differences regarding the make-up and requirements of the LWCC board of directors from the Louisiana Citizens board of directors. Because Florida Citizens was the model for Louisiana Citizens, we extended our comparison to include the requirements for Florida Citizens' board of governors, as well. The following is a list of significant differences we identified.

Board Member Qualification Requirements. The Louisiana Citizens law does not require that any member of Citizens' board of directors have executive level experience, as do the LWCC statutes. The LWCC statutes require that one board member be a workers' compensation insurance agent with executive level experience in the field.

Term Limits. The Louisiana Citizens law does not stipulate term limits for members of the board of directors, as do the LWCC statutes and the Florida statutes. Gubernatorial appointees to LWCC's board of directors are not subject to term limits; however, policyholder representatives on its board are limited to three terms. A 70% majority of voting policyholders may extend this term to four or more terms. Members of Florida Citizens' board of governors are appointed for three-year terms.

Removal Procedures. The Louisiana Citizens law does not provide for the removal of members of the Citizens board of directors, as do the LWCC statutes and the Florida statutes. The LWCC statutes say that five board members may vote to expel a board member with at least three consecutive unexcused absences from regularly scheduled board meetings, for neglect of duty, or for malfeasance. The statutes for Florida Citizens state that all members of the board of governors are subject to removal at will by the officers who appointed them.

Manager Requirements. The Louisiana Citizens law does not mandate the board of directors to require its manager to have experience in an appropriate field, as does the LWCC law. The LWCC law states that the LWCC board must require its manager to have proven successful experience as an executive at the general management level and in the field of workers' compensation insurance.

Ethics Provisions. The Louisiana Citizens law does not include explicit provisions stating that members of the board of directors are subject to certain ethics requirements. The LWCC statutes require board members to make written disclosure of any thing of economic value that they solicit or accept from any person or entity that has a contractual relationship with the corporation. The Florida Citizens law says that members of the Citizens board of governors are subject to the statutory code of ethics, must report financial interests, and may not knowingly accept gifts from such person.

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Need more information?

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A copy of this report is available on our Web site at www.lla.state.la.us.

This document is produced by the Louisiana Legislative Auditor, State of Louisiana, Post Office Box 94397, Baton Rouge, Louisiana 70804-9397 in accordance with R.S. 24:513. Ten copies of this public document were produced at an approximate cost of $24.10. This material was produced in accordance with the standards for state agencies established pursuant to R.S. 43:31.