LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION A COMPONENT UNIT OF THE STATE OF LOUISIANA

STATUTORY BASIS FINANCIAL STATEMENT AUDIT
FOR THE YEAR ENDED DECEMBER 31, 2008
ISSUED FEBRUARY 10, 2010

LEGISLATIVE AUDITOR
1600 NORTH THIRD STREET
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BATON ROUGE, LOUISIANA 70804-9397

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LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA

February 2, 2010

Independent Auditor's Report
on the Statutory Basis Financial Statements

BOARD OF GOVERNORS OF THE
LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION
STATE OF LOUISIANA
Metairie, Louisiana

We were authorized by Louisiana Revised Statute 22:2306 to audit the accompanying statutory basis financial statement of admitted assets, liabilities, and accumulated surplus of the Louisiana Citizens Property Insurance Corporation (Citizens), a component unit of the State of Louisiana, as of December 31, 2008, and the related statutory basis statements of operations, changes in accumulated surplus, and cash flows for the year then ended as listed in the foregoing table of contents. These financial statements are the responsibility of Citizens' management.

As discussed in Exhibits A and B, Citizens' internal controls, information systems, and accounting records contained major inadequacies. The inadequacies in user access controls and other weaknesses in its computer systems, the lack of monitoring of the activities of Citizens and its service providers, the deficiencies in Citizens' processes to develop loss liabilities, receivables, and other financial statement information, and other matters as further discussed in Exhibits A and B collectively do not provide adequate safeguards over Citizens' assets or assure the proper recording of transactions. These inadequacies made it impractical to apply sufficient auditing procedures to enable us to express an opinion on the fair presentation of the financial statements.

As described in note 1-A to the financial statements, these financial statements were prepared using accounting practices prescribed or permitted by the Louisiana Department of Insurance, which is a comprehensive basis of accounting other than generally accepted accounting principles. The variances between such practices and accounting principles generally accepted in the United States of America and the effects on the accompanying financial statements are described in note 15 and are considered to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of Louisiana Citizens Property Insurance Corporation as of December 31, 2008, or the results of its operations or its cash flows for the year then ended.

Because we are not able to apply sufficient auditing procedures to satisfy ourselves as to the amounts included in the statutory basis financial statements, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying financial statements.

During August and September 2005, the State of Louisiana suffered considerable damage from two major hurricanes, Katrina and Rita, resulting in the President of the United States declaring Louisiana a major disaster area. Class action lawsuits have been filed against Citizens related to these events. Because of the severity of these events and the resulting damages sustained by the state, it is unknown exactly what economic impact recovery efforts will have on state and local government operations. Louisiana Revised Statute 22:2307 provides Citizens with a process to alleviate its deficits through regular and emergency assessments. In addition, Citizens issued revenue bonds in April 2006 to help address the losses caused by the catastrophic events. The long-term effects of these events on Citizens and the state cannot be determined at this time.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 2, 2010, on our consideration of Citizens' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis on pages 5 through 13 is not a required part of the statutory financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of attempting to form an opinion on the accompanying statutory basis financial statements of the Louisiana Citizens Property Insurance Corporation taken as a whole. The accompanying supplemental information schedules, identified in the Table of Contents, are presented for the purpose of additional analysis and are not a required part of the financial statements. The supplemental information schedules have been subjected to the auditing procedures applied in the audit of the statutory basis financial statements. For reasons previously stated in the second and fifth paragraphs of this report, we do not express an opinion on the statutory basis financial statements. Similarly, we do not express an opinion on the supplemental information schedules.

This report is intended solely for the information and use of the Board of Governors and management of Louisiana Citizens Property Insurance Corporation, the Louisiana Department of Insurance, and the Louisiana Legislature. This report is not intended to be and should not be used by anyone other than these specified parties. Under Louisiana Revised Statute 24:513, this report is distributed by the Legislative Auditor as a public document.

Respectfully submitted,

Daryl G. Purpera

Daryl G. Purpera, CPA
Temporary Legislative Auditor

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CITIZENS09

Company Background

This discussion provides an assessment by management of the financial position, results of operations, cash flow and liquidity for Louisiana Citizens Property Insurance Corporation (LCPIC). LCPIC was established in 2003 by the Louisiana Legislature as a nonprofit corporation to operate residual market insurance plans effective January 1, 2004. The objective of LCPIC is to provide essential property insurance for residential and commercial property applicants who are unable to procure insurance through the voluntary market. LCPIC is the successor to the program established by Act 424 of the 1992 Regular Legislative Session designated as the "Fair Access to Insurance Requirements Plan" or otherwise known as the Louisiana Joint Reinsurance Plan (Fair Plan) and the Louisiana Insurance Underwriting Plan (Coastal Plan). Information presented in this discussion supplements the financial statements, schedules, and exhibits in Louisiana Citizens Property Insurance Corporation's 2008 Annual Statement.

Major events occurring in 2008 for LCPIC were:

- LCPIC moved its data center to a new secured location in March 2008.
- Separation from Property Insurance Association of Louisiana in April 2008.
- New senior management team put in place.
- Decision to replace current policy and claim management system was made.
- LCPIC's financial statements for the years of 2005, 2006, and 2007 were completed and audited with the 2008 financial statement filed by its due date.
- LCPIC completed two rounds of depopulation in 2008 transferring 40,000 policies (approximately 25% of total policies) and $8.4 billion of exposure to the private insurance market.
- Three catastrophe occurrences in 2008. Incurred losses from one hurricane, Hurricane Gustav, exceeding LCPIC's reinsurance retention. A breakdown of the 2008 catastrophe loss occurrences is as follows:

Storm Name	Date of Occurrence	No. of Reported Claims	Incurred Losses (millions)
Windstorm (Cat. #40)	05/13/08 - 05/15/08	517	$2.8
Hurricane Gustav	08/31/08 - 09/03/08	50,953	$332.6
Hurricane Ike	09/12/08 - 09/14/08	3,637	$12.6

Financial Position

LCPIC's financial position at December 31 was as follows:

Balance Sheet (in thousands of dollars - 000)	2008	2007
Assets		
Common stocks and short-term investments	$190,307	$332,330
Cash	23,053	161,940
Total invested assets	213,360	494,270
Amounts recoverable from reinsurers	55,374	17,435
Reinsurance reinstatement coverage recoverable	7,714	
Emergency assessment receivable	20,065	16,540
Receivable from claims settlement	15,000	
Other asset	1,005,412	1,007,252
Total assets	$1,316,925	$1,535,497
Liabilities and Policyholders' Surplus		
Unpaid loss and loss adjustment expenses	$175,758	$370,738
Unearned premiums	112,382	136,008
Service fees payable to service provider		29,820
Other liabilities	1,032,883	1,033,351
Total liabilities	1,321,023	1,569,917
Total policyholders' surplus	(4,098)	(34,420)
Total liabilities and policyholders' surplus	$1,316,925	$1,535,497

Assets

Total assets decreased by $219.0 million (14.2%) primarily due to cash used to pay claims for catastrophe related losses, principally for hurricanes Gustav and Katrina as noted below.

The funds that comprise common stocks and short-term investments are entirely related to the assessment revenue bond obligations issued in 2006 to pay the Hurricane Katrina losses. These assets are money market securities and repurchase agreement securities, both held by the bond custodian, Regions Bank. The common stocks and short-term investments decreased by $142.0 million in 2008, primarily due to a drawdown of the loan proceeds made by LCPIC to offset cash payments of Katrina losses.

LCPIC's cash balances decreased in 2008 by $138.9 million as a result of the payments for catastrophe related losses and expenses exceeding premiums collected. The payments (in millions) for 2008 by catastrophic event are as follows:

Catastrophe Description	Date of Loss	Paid Losses (millions)
Hurricane Gustav	08/31/08 - 09/03/08	$253.6
Hurricane Katrina	08/25/05 - 08/29/05	$103.1
Hurricane Rita	09/20/05 - 09/24/05	$13.1
Hurricane Ike	09/12/08 - 09/14/08	$10.4
Windstorm (Cat #40)	05/13/08 - 05/15/08	$2.6
Total Paid Losses		$382.8

Amounts recoverable from reinsurers increased by $37.9 million as Hurricane Gustav losses exceeded LCPIC's retention of its Property Catastrophe Excess of Loss Reinsurance Contract during the latter part of the 4th Quarter. A recoverable was recorded in the amount of $7.7 million as of year-end for the return of reinstatement premium which is offset by the payable owed to the reinsurers under the primary reinsurance contract.

The receivable for the emergency assessment from insurers of the voluntary market increased $3.5 million (21%) as compared to 2007. This growth is due to the increase in the assessment rate applied to the insurers' direct written premiums of 5.0% in 2008 as compared to 3.6% in 2007.

A settlement was reached in connection with a Hurricane Katrina/Hurricane Rita bad faith class action suit. LCPIC issued payment to a court trustee for the maximum judgment of $35.0 million in November 2008. Further analysis by the class action attorneys determined that the actual payout would be no more than $20.0 million, with the remaining funds to be paid back to LCPIC. Based upon the developments noted above, LCPIC accrued a $15.0 million receivable at December 31, 2008.

Liabilities

Total liabilities decreased by $248.9 million (16%) primarily due to the $201.0 million reduction in unpaid loss and loss adjustment expenses as described below.

Unpaid losses and loss adjustment expenses (LAE) are stated at LCPIC's estimate of the ultimate cost, net of reinsurance, of settling all incurred but unpaid claims. Unpaid losses and loss adjustment expenses are not discounted and no estimate for salvage and subrogation is applied as a reduction to the unpaid losses. The estimate for unpaid losses and loss adjustment expenses is closely monitored and adjusted for changes in economic, social, judicial, and legislative conditions, as well as historical trends. LCPIC uses various development modeling techniques to assist in the evaluation of its reserves under the direction of its chief actuary.

Management believes that its reserves are adequate, but establishing reserves is a judgmental and inherently uncertain process. It is therefore possible that as conditions and experience develops, reserve adjustments may be required in the future.

Activity with respect to unpaid losses and LAE for the last two years is displayed below.

Losses and LAE (000)	2008	2007
Unpaid losses and LAE at beginning of year	$370,738	$536,125
Losses and LAE incurred in current year:		
For current year losses and LAE	301,933	78,463
For prior year losses and defense and cost containment expenses	(80,905)	(11,384)
For prior year adjusting and other expenses	(18,685)	14,496
Income statement amounts	202,343	81,575
Losses and LAE paid in current year:		
For current year losses and LAE	(263,101)	(42,247)
For prior year losses and LAE	(134,222)	(204,715)
Underwriting exhibits paid amounts	(397,323)	(246,962)
Unpaid losses and LAE at end of year	$175,758	$370,738

LCPIC experienced favorable development of unpaid loss and LAE estimates. The 2005 accident year storms, hurricanes Katrina and Rita, were the principle drivers of this favorable development. The decrease in estimates for prior loss years of $99.6 million ($80,905 + $18,685) stated above is derived from the decrease in IBNR reserves for hurricanes Katrina and Rita.

Unearned premiums decreased $23.6 million (17%). The majority of this decrease is attributable to the ceded unearned premium stemming from LCPIC's depopulation program in 2008. LCPIC's depopulation program consisted of two separate rounds in which 40,000 policies (approximately 25% of total policies) and $68.0 million in annualized premium were ceded to four companies that were a part of the State Incentive Program and three companies that participated outside of the State Incentive Program.

In 2008, LCPIC reclassified the service provider fees payable as an expense accrual to the underwriting income. A reduction of $23.3 million in fees payable to service providers resulted from a revised invoice validation and approval process, and a reduction to the payable for advance Hurricane Katrina temporary living expense payments of $10.7 million that were reimbursed to the service provider by LCPIC in October 2005.

Policyholders' Surplus

Total policyholders' surplus increased by $30.3 million (88%) in 2008.

The primary reasons for the increase in total policyholders' surplus were:

1. Emergency assessment income was greater than debt service costs on long-term debt obligations on assessment revenue bonds issued to offset the losses incurred by LCPIC for Hurricane Katrina.

2. Reduction of claim reserves, primarily those of hurricanes Katrina and Rita.

3. Offsetting these gains was a loss due to claims expenses to pay catastrophe related storms.

Results of Operations

LCPIC's operating results and key financial ratios are presented in the following table.

Statement of Income and Ratios (000)	2008	2007
Premiums earned	$188,090	$158,691
Losses incurred	(161,437)	(68,659)
LAE incurred	(34,841)	(12,916)
Underwriting expenses	(39,709)	(48,756)
Underwriting gain (loss)	(47,897)	28,360
Net investment loss	(51,335)	(19,794)
Other income	105,339	103,621
Net icome	6,107	112,187
Premiums written	$161,049	$205,337
Loss Ratio	85.8%	43.3%
LAE Ratio	18.5	8.1
Underwriting expense ratio	24.7	23.7
Combined ratio	129.0%	75.1%

The combined ratio expresses the sum of the costs for losses, LAE and underwriting expenses as a percentage of premiums (premiums earned for the loss and LAE ratios and premiums written for the underwriting expense ratio). The ratio is a recognized industry measure of underwriting performance. The ratio increased in 2008 because of a higher loss and LAE ratio.

Although direct written premium increased 5% in 2008 versus 2007, net premiums earned grew $29.4 million (19%) because of the reduction in the liability for unearned premiums from 2007 to 2008. The premium growth in 2007 caused the unearned premium liability to increase at the end of 2007; therefore, a greater proportion of the premiums written in 2007 were earned in 2008.

The increase in incurred losses and LAE of $114.7 million, or 141%, is from the catastrophe loss occurrences in 2008. LCPIC's total incurred losses from Hurricane Gustav are $332.6 million and $12.6 million from Hurricane Ike. The losses were offset by the reduction in incurred but not reported (IBNR) reserves of $47.6 million.

Underwriting expenses declined because of the ceding commission recognized in 2008 from the depopulation program.

In 2008, net investment losses increased $31.5 million because of greater interest costs for the $300.0 million variable rate bonds associated with LCPIC's bond program established in 2006. The deterioration of the financial markets in the latter half of 2008 increased the interest cost of the variable rate bonds. LCPIC converted the variable rate bonds to fixed rate bonds in 2009.

Other income decreased moderately by $1.7 million (2%) because of phasing out the market equalization fee applicable to LCPIC's policies. The market equalization fees were established by assessing all policies with effective dates beginning at mid-year of 2006 and were assessed on all policies with an effective date during the following twelve-month period. This decrease was offset by the increase in the emergency assessment income because of the assessment rate increase of 5% in 2008 as compared to 3.6% in 2007.

Cash Flow and Liquidity

Cash Flow

Primary sources of cash include proceeds from investments sold, matured, or repaid and primary uses of cash include cash used in operations, the purchase of investments, financing, and other miscellaneous uses.

Cash flow from operations decreased by $220.6 million in 2008 compared to 2007.

The premiums collected decreased $24.9 million (13%) for 2008. Although LCPIC experienced an increase in total net premiums earned, as described earlier, this increase was primarily driven by changes in unearned premium rather than by premiums collected. The premiums collected are lower because LCPIC ceded premiums for the depopulation program in 2008.

Net investment income declined in 2008 because of higher interest cost paid on the $300.0 million variable rate securities associated with bond debt and interest income was lower due to a utilization of funds from securities held to defray continued Katrina claim costs paid in 2008.

The losses paid increased $151.6 million (66%) because of hurricanes Gustav and Ike which occurred in 2008 and hurricanes Katrina and Rita which occurred in 2005. The amounts paid in 2008 for these storms were in excess of $382.8 million as noted in the Assets section. Catastrophe loss payments accounted for 84% of the total loss payments, while noncatastrophe related losses were only 16% of the total losses paid in 2008.

Expenses paid increased by $14,446 (20%) in 2008 as compared to 2007. This increase was driven by claim settlement costs associated with hurricane-related claims. In 2007, LCPIC's state premium tax payments were held until a determination of LCPIC's premium tax status was made. In 2008, the Louisiana Insurance Department determined that LCPIC is subject to state premium taxes; therefore, LCPIC paid $3.0 million of premium taxes which included $1.5 million for prior years. In 2008, LCPIC paid $3.0 million for consulting work for programming and maintenance of its policy/claim system and to reconcile bank accounts from October of 2005.

The market equalization charge income decreased in 2008 by $20.3 million as compared to 2007. The market equalization charge income is a surcharge which the governing board of LCPIC is authorized to levy on all plan policies to place LCPIC's policyholders on equal standing with the policyholders in the voluntary market during the period in which regular assessments are being assessed by LCPIC. The majority of this income was earned in 2007.

Emergency assessment income received increased by $25.6 million (33%) because of the assessment rate increase of 5.0% in 2008 as compared to 3.6% in 2007.

The cash outflow for other financing activities is primarily related to the service provider fees that were temporarily held until a revised invoice validation and approval process was determined. In addition, a reduction was made to accounts payable for Hurricane Katrina temporary living expense payments of $10.7 million that were actually reimbursed to the service provider by LCPIC in October 2005, without a corresponding reduction in accounts payable.

Liquidity

All liquid funds held by LCPIC are kept in interest-bearing commercial bank accounts that are 100% collateralized. Although LCPIC's liquidity was impacted by hurricanes Gustav and Ike in the fall of 2008 and Hurricane Katrina claim settlement payments, LCPIC was able to manage a $250.0 million catastrophe event without initiating an assessment to the voluntary marketplace.

In 2005, LCPIC did not have sufficient funds to pay 80,000 claims resulting from hurricanes Katrina and Rita. LCPIC borrowed $978.2 million, of which $678.2 million is fixed rate bonds and $300.0 million is variable auction rate bonds. The debt service of these bonds is paid through emergency assessments on property insurance policies written in the State of Louisiana. The emergency assessments are remitted quarterly to the bond trustee. The ongoing turmoil in the auction rate market caused the variable rate bonds to auction at much higher rates than originally anticipated. Developing a plan to restructure the variable rate bonds was a major priority of LCPIC's management in 2008.

In addition to policyholder premiums, LCPIC has much broader range of resources available to pay losses and repay debt obligations than does a typical insurer. LCPIC can institute a regular assessment on the state insurance industry of up to 10% for deficits each year, and an emergency assessment of up to 10% on homeowners of the State of Louisiana up to 10% per storm event to pay debt incurred for storms such as hurricanes Katrina and Rita. No line of credit is currently maintained for catastrophe losses and general corporate purposes; however, LCPIC uses reinsurance to mitigate the possibility of assessments.

Pending Litigation

There are approximately 1,926 open litigation matters against LCPIC. Approximately 85% to 90% of these matters are first-party suits related to hurricanes Katrina and Rita.

The balance of the litigated matters are related to fire losses, third-party bodily injury claims, subrogation matters or examinations under oath of insured's with questionable coverage claims.

LCPIC is also a defendant in three class action suits resulting from hurricanes Katrina and Rita.

- *Press v. Louisiana Citizens Property Insurance Corporation*. The plaintiffs in this suit allege that approximately 25% (19,250) adjusted Katrina and Rita claims did not include payments for overhead and profit. This matter was certified in July 2008 and an appeal of the certification is currently pending in the 4th District of the Louisiana Court of Appeals. If the appeal is denied by the 4th District, LCPIC will also be taking writs to the Supreme Court of Louisiana. Until the question of certification is finally decided by the appellate courts, it is difficult to determine LCPIC's potential exposure with any certainty. However, LCPIC does not anticipate a significant judgment in this matter.

- *Thibodeaux v. Louisiana Citizens Property Insurance Corporation*. The Plaintiffs in this suit allege that LCPIC failed to include the $65.00 application fee on its declaration page for all new policies. Plaintiffs seek return of the $65.00 fee for all affected policyholders. This matter was certified as a class action by the court on February 17, 2009 and LCPIC will be appealing this order to the 1st Circuit Court of Appeals on or before March 15, 2009. Again, if the appeal is denied by the 1st Circuit, LCPIC will be taking writs to the Supreme Court of Louisiana. In addition to the issues related to certification, there are a number of legal issues related to the merits that will need to be addressed by the court. The resolution of any of these issues could result in this case being dismissed as a whole. Once again, it is difficult to assess the potential exposure of this matter until such time as the certification issue is finally decided by the appellate courts. However, LCPIC does not anticipate a significant judgment in this matter.

- *Oubre v. Louisiana Citizens Property Insurance Corporation*. The plaintiffs in this suit allege that LCPIC failed to timely initiate loss adjustment as required by Louisiana statutory law, thus exposing LCPIC to mandatory penalties in the amount of $5,000.00. This matter was certified as a class action and is set for trial to take place on March 23, 2009. Class certification has been upheld by the Court of Appeal. Motions for summary judgment seeking an award are currently pending and awaiting trial court ruling. The class is alleged to consist of approximately 60,000 members. LCPIC has filed cross motions for summary judgment seeking the dismissal of this matter which are also pending before the trial court. LCPIC anticipates a significant judgment in this matter from the trial court, but believes the Court of Appeal will provide relief from the anticipated judgment from the trial court.

These matters are being vigorously defended by nine outside law firms. Based upon the reports provided by counsel regarding these suits, LCPIC does not anticipate any significant judgments.

Future Plans

LCPIC has $300.0 million in variable rate bonds outstanding that are currently trading at higher than anticipated rates. LCPIC's plan is to convert the variable rate bonds to fixed rate bonds and lock in lower interest rates for the life of the bonds.

LCPIC has an excess of loss catastrophe reinsurance program that provided coverage for 90% of $500.0 million after a $200.0 million retention that expires on June 1, 2009. LCPIC is in the process of negotiating a new reinsurance program for the 2009 storm season.

As a result of multiple issues, LCPIC's policy and claim management system was reviewed and a decision was made to purchase a new policy and claim management system. An RFP was prepared and released in the spring of 2008 and a contract for a new policy and claim management system was awarded in the first quarter of 2009. LCPIC is currently establishing processes to implement the new system and retire the existing policy and claim management system.

To the extent that the above comments about future plans constitute forward-looking statements, these statements are not guaranties of future performance. Forward-looking statements are based on current expectations and projections about future events and are subject to risks, uncertainties, and assumptions about LCPIC; economic and market factors; judicial rulings; and the insurance industry, among other things. Actual events may differ materially from those expressed in forward-looking statements.

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Statement A

LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION
STATE OF LOUISIANA

Statement of Admitted Assets, Liabilities, and Accumulated Surplus (Statutory Basis)
December 31, 2008

ADMITTED ASSETS	
Cash and invested assets:	
Stocks	$149,491,381
Cash and short-term investments	63,868,431
Total cash and invested assets	213,359,812
Investment income due and accrued	4,933
Premium receivables and agent's balances, net (note 12)	22,400,107
Reinsurance receivables, net	55,374,356
EDP equipment and software	4,709,697
Emergency assessments receivables - 2005	978,205,000
Emergency assessments receivables - companies	20,065,414
Reinsurance reinstatement recoverable	7,713,861
Claims settlement receivable	15,000,000
Commissions due from agents	92,295
Total assets	$1,316,925,475
LIABILITIES AND ACCUMULATED SURPLUS	
Liabilities:	
Loss reserves	136,365,099
Loss adjustment expense reserves	39,393,775
Commissions payable to agents	4,314,894
Other expenses (excluding taxes, licenses, and fees)	3,237,939
Taxes, licenses, and fees	741,786
Bonds payable (note 6)	1,003,566,675
Interest payable	4,849,043
Unearned premiums	112,381,831
Advance premiums	6,646,491
Ceded reinsurance premiums payable, net of ceding commissions	(2,067,332)
Amounts withheld or retained by company for account of others	11,867
Remittances and items not allocated	63,854
Provision for reinsurance	5,343,142
Accounts payable	11,697
Unearned tax exempt surcharge	4,009,978
Take-out program - premium payable	1,083,393
Take-out program - initial assumed	1,069,417
Total liabilities	1,321,023,549
Accumulated Surplus:	
Funds restricted for debt service	53,027,923
Unassigned funds	(57,125,997)
Total accumulated surplus	(4,098,074)
Total liabilities and accumulated surplus	$1,316,925,475

The accompanying notes are an integral part of this statement.

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Statement B

LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION
STATE OF LOUISIANA

Statement of Operations (Statutory Basis)
For the Year Ended December 31, 2008

Premiums earned	$188,090,054
Losses and other underwriting expenses:	
Losses incurred	161,436,708
Loss adjustment expenses incurred	34,840,995
Other underwriting expenses incurred	39,709,154
Total underwriting deductions	235,986,857
Total underwriting income	(47,896,803)
Net investment income (loss)	(51,334,960)
Net gain (loss) from premium balances charged off (note 12)	(2,670,191)
Finance and service charges not included in premiums	837,924
Application fees	3,474,120
Emergency assessment income (note 8)	103,646,244
Market equalization charges	14,030
Nonsufficient funds fees recovered	16,829
Miscellaneous income	19,601
Net income (loss)	$6,106,794

The accompanying notes are an integral part of this statement.

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Statement C

LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION
STATE OF LOUISIANA

Statement of Changes in Accumulated Surplus (Deficit) - (Statutory Basis)
For the Year Ended December 31, 2008

Balance at January 1, 2008	($34,420,396)
Net income	6,106,794
Change in nonadmitted assets	6,422,217
Change in provision for reinsurance	(3,115,772)
Tax exempt surcharge	8,400,680
Change in unearned tax exempt surcharge	70,267
Excess regular recoupments	1,712,073
Effect on surplus of prior period adjustment	10,726,063
Balance at December 31, 2008	($4,098,074)

The accompanying notes are an integral part of this statement.

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Statement D

LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION
STATE OF LOUISIANA

Statement of Cash Flows (Statutory Basis)
For the Year Ended December 31, 2008

CASH FLOWS FROM OPERATING ACTIVITIES	
Premiums collected, net of reinsurance	$170,756,023
Net investment income received	(50,618,924)
Miscellaneous income	105,338,557
Benefit and loss related payments	(381,870,829)
Commissions and expenses paid	(88,193,243)
Net cash used by operating activities	(244,588,416)
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from investments sold, matured or paid	306,376,753
Cost of investments acquired	(213,200,864)
Net cash from investing activities	93,175,889
CASH FLOWS FROM FINANCING AND MISCELLANEOUS ACTIVITIES	
Other cash provided (applied)	(36,321,780)
Net cash used by capital financing activities	(36,321,780)
Net decrease in cash and cash equivalents	(187,734,307)
Cash and cash equivalents, beginning of year	251,602,738
CASH AND CASH EQUIVALENTS, END OF YEAR	$63,868,431

The accompanying notes are an integral part of this statement.

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INTRODUCTION

Louisiana Citizens Property Insurance Corporation (Citizens) was created in accordance with provisions of Louisiana Revised Statute (LRS) 22:2293, to operate insurance plans which provide property insurance for residential and commercial property, solely for applicants who are in good faith entitled, but are unable, to procure insurance through the voluntary market. Citizens operates residual market insurance programs, throughout the State of Louisiana (the State), designated as the Coastal Plan (succeeded the Louisiana Insurance Underwriting Plan) and the Fair Access to Insurance Requirements Plan (FAIR Plan) (succeeded the Louisiana Joint Reinsurance Plan). The Coastal Plan is for property insurance written on locations between the Gulf of Mexico and the Intracoastal Waterway and the FAIR Plan is for property insurance above the Intracoastal Waterway.

Citizens began operations on January 1, 2004, with its headquarters and corporate offices located in Metairie, Louisiana. It is governed by a board of directors consisting of 15 members, who serve without compensation. The Board consists of the Commissioner of the Department of Insurance, the state treasurer, the chairman of the House Committee on Insurance, the chairman of the Senate Committee on Insurance or their designees, six representatives appointed by the Governor, two members appointed by the Commissioner of the Department of Insurance, and three members appointed by the governor.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. ACCOUNTING PRACTICES

The financial statements of the Louisiana Citizens Property Insurance Corporation are presented on the basis of accounting practices prescribed or permitted by the Louisiana Insurance Department.

The Louisiana Insurance Department recognizes only statutory accounting practices prescribed or permitted by the State of Louisiana for determining and reporting the financial condition and results of operations of an insurance company, for determining its solvency under Louisiana Insurance Law. The National Association of Insurance Commissioners' (NAIC) Accounting Practices and Procedures Manual (NAIC SAP) has been adopted as a component of prescribed or permitted practices by the State of Louisiana. The state has adopted certain prescribed accounting practices that differ from those found in NAIC SAP. Specifically, the depreciated useful life for electronic data processing (EDP) equipment and operating system software where the maximum amount of time for operating system software is five years and equipment may be depreciated over ten years. In NAIC SAP, EDP equipment and operating system software shall be depreciated for a period not to exceed three years. The Commissioner of Insurance has the right to permit other specific practices that deviate from prescribed practices.

Citizens, with the explicit permission of the Commissioner of Insurance of the State of Louisiana, records the depreciation of its EDP equipment over a period of ten years and records depreciation of its EDP operating system software over a period of five years instead of the three year period required by NAIC SAP. If EDP equipment and operating system software were depreciated over three years, EDP equipment and operating system software, net income, and statutory surplus would be decreased by $641,439 as of December 31, 2008.

A reconciliation of Citizens net income and capital and surplus between NAIC SAP and practices prescribed and permitted by the State of Louisiana is shown below.

		State of Domicle	2008
(1)	Net Income, Louisiana state basis	Louisiana	$6,106,794
(2)	State Prescribed Practice (Income):		
	Depreciation of EDP Equipment and Software	Louisiana	(3,287,256)
(3)	State Permitted Practice (Income):		
	Depreciation of EDP Equipment and Software	Louisiana	2,645,817
(4)	Net Income, NAIC SAP	Louisiana	$5,465,355
(5)	Statutory Surplus Louisiana basis	Louisiana	($4,098,074)
(6)	State Prescribed Practice (Surplus):		
	EDP Equipment and Software, net	Louisiana	(3,287,256)
(7)	State Permitted Practice (Surplus):		
	EDP Equipment and Software, net	Louisiana	2,645,817
(8)	Statutory Surplus, NAIC SAP	Louisiana	($4,739,513)

B. USE OF ESTIMATES IN THE PREPARATION OF THE FINANCIAL STATEMENTS

The preparation of financial statements in conformity with Statutory Accounting Principles requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities. It also requires disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results may differ from those estimates.

Material estimates are as follows:

1. Loss reserves as stated in note 1.C.3.

2. Unearned premium reserves are estimated based upon the daily pro rata method as noted in 1.C.

3. An estimate is established for the non-admitted portion of the premiums receivable balances as stated in note 12.

C. ACCOUNTING POLICY

Premiums are earned over the terms of the related insurance policies and reinsurance contracts. Unearned premium reserves are established to cover the unexpired portion of premiums written. Such reserves are computed by pro rata methods for direct and ceded business.

Expenses incurred in connection with acquiring new insurance business, including such acquisition costs as sales commissions and servicing carrier fees, are charged to operations as incurred. Expenses are reduced for ceding allowances received or receivable.

In addition, Citizens used the following accounting policies:

1. Short-term investments are stated at market.

2. Common stocks are stated at market.

3. Unpaid losses and loss adjustment expenses include an amount determined from individual case estimates and loss reports and an amount, based upon past experience, for losses incurred but not reported. Such liabilities are necessarily based upon assumptions and estimates and while management believes the amount is adequate, the ultimate liability may be in excess of or less than the amount provided. The methods for making such estimates and for establishing the resulting liability is continually reviewed and any adjustments are reflected in the period determined.

4. Citizens has a capitalization policy to ensure its fixed assets and related expenses are properly matched against revenues generated through the use of the assets under Statutory Accounting Principles. Fixed assets include items such as furniture, office equipment, computers, and buildings, if applicable. Thresholds are applied to fixed assets to determine if the assets should be capitalized or expensed. Capitalized assets are reported on the Balance Sheet as furniture and fixtures and electronic data processing equipment to comply with statutory reporting requirements. All movable property over $5,000 is capitalized based upon a variable useful life depending on the descriptive category for which that property meets. All computer software purchased or developed for internal use over $1,000,000 is capitalized and amortized over five years. Buildings and improvements over $100,000 are capitalized and depreciated over 40 years. Leasehold improvements exceeding $100,000 are capitalized and depreciated over the lesser of 20 or 40 years or the remaining lease term. The straight-line depreciation method is used for the depreciation of capital assets and the assets are assumed to have no salvage value and a full year of depreciation will be taken in the year the asset is placed into service.

2. ACCOUNTING CHANGES AND CORRECTIONS OF ERRORS

An error was discovered when a loss recovery of $7,937 was recorded offsetting losses paid when it was systematically identified as subrogation in the prior year. A correction has been recorded to reclassify the loss recovery as subrogation. Since subrogation is a component of losses incurred, no adjustment has been made in the financial statement.

An error was discovered in compiling and reporting the liability to a service provider in which a reduction to this liability was not applied when it was paid. In the prior year, servicing fees payable to service provider was overstated by $10,734,000. The loss adjustment expense reserves liability has been adjusted in the current year to correct this error.

3. INVESTMENTS

Repurchase Agreements

In 2006, the company entered into a Repurchase Agreement with Societe Generale, New York Branch to invest a portion of the Debt Service Reserve Fund. The agreement requires Societe Generale to maintain margins on collateral of 104%-105% of market value depending on the type of collateral. Acceptable securities are Ginnie Maes, Government Agencies, Mortgage-backed securities of FHLMC or FHLB and U.S. Treasury securities. The custodian for the collateral is Wells Fargo Bank, N.A.

The fair market value of collateral accepted from Societe Generale as of December 31, 2008, was $46,843,020. The investment balance was $40,815,846 and the collateral percentage was 114.77%.

4. INVESTMENT INCOME

Citizens nonadmits investment income due and accrued if amounts are over 90 days past due. The total amount excluded was $0.

5. INCOME TAXES

Pursuant to Private Letter Ruling 160165-03 from the Internal Revenue Service, Citizens constitutes an integral part of the State of Louisiana and its income is exempt from federal income tax. Obligations issued by Citizens constitute obligations to the State of Louisiana within the meaning of section 103(c)(1) of the Internal Revenue Code.

6. DEBT

Citizens has outstanding $978,205,000 of assessment revenue bonds of which $678,205,000 are fixed rate bonds and $300,000,000 are auction rate securities, both issued on April 11, 2006. All assessment and bond payments are held and paid by the bond trustee and there are no collateral requirements associated with these bonds. Bonds payable are reported on Statement A gross of the unamortized bond premium of $25,361,675. The maturity schedule of the fixed rate bonds is as follows:

Maturity	Principal Amount	Coupon	Effective
2009	$4,795,000	4.00%	3.72%
2009	27,005,000	5.00%	3.72%
2010	5,090,000	4.00%	3.77%
2010	29,270,000	5.25%	3.77%
2011	12,225,000	4.00%	3.85%
2011	22,855,000	5.00%	3.85%
2012	1,820,000	4.00%	3.94%
2012	35,915,000	5.00%	3.94%
2013	5,150,000	4.00%	4.04%
2013	34,450,000	5.25%	4.04%
2014	40,595,000	5.25%	4.14%
2015	43,745,000	5.00%	4.21%
2016	44,915,000	5.00%	4.26%
2017	48,180,000	5.00%	4.31%
2018	49,570,000	5.00%	4.35%
2019	53,065,000	5.00%	4.38%
2020	55,720,000	5.00%	4.41%
2021	57,485,000	5.00%	4.43%
2022	61,380,000	5.00%	4.45%
2023	20,845,000	4.50%	4.61%
2023	24,130,000	5.00%	4.47%
Total	$678,205,000		

Total interest paid in 2008 on the fixed rate bonds was $33,776,013.

The terms of the auction rate securities are as follows:

	Principal Amount	Standard Auction Period	Initial Auction Date	Interest Paid in 2008
	$75,000,000	35 days	05/02/06	$6,514,740
	75,000,000	35 days	05/09/06	7,717,500
	75,000,000	35 days	05/16/06	7,514,135
	75,000,000	35 days	05/23/06	6,784,896
Total	$300,000,000			$28,531,271

7. RETIREMENT PLANS

Defined Benefit Plan

Prior to September 1, 2008, Citizens sponsored a non-contributory defined benefit pension plan covering all employees that were hired on April 1, 2008, from a services agreement with the Property Insurance Association of Louisiana (PIAL) in which retirement expenses were previously reimbursed to PIAL. Retirement expenses reimbursed to PIAL as of March 31 were $61,293. For the period of April 1 to August 31, 2008, Citizens contributed $34,761 to the defined benefit pension plan. In December, Citizens contributed an additional $369,000 to offset market value asset losses in the defined benefit pension plan. As of December 31, 2008, Citizen's defined benefit pension plan was fully funded.

As of September 1, 2008, Citizens froze its defined benefit pension plan and converted to a defined contributed pension plan.

Defined Contribution Plan

Citizens' employees are covered by a qualified defined contribution pension plan sponsored by Citizens. As of September 1, 2008, Citizens froze its defined benefit pension plan and converted to a defined contributed pension plan.

Citizens contributes 11% of each employee's wages to the defined contribution plan. Citizens's contribution for the plan was $249,431 in 2008. Citizens expenses the contributions each month and carries no assets or liabilities for the defined contribution pension plan on its balance sheet.

8. CAPITAL AND SURPLUS

Changes in balances of special surplus funds from the prior year are due to collections made by Citizens during the normal course of collecting policy component charges. The policy component charge affecting special surplus funds is the tax exempt surcharge. Also reflected in special surplus funds is the collection of additional regular assessments received from licensed insurers that elected to charge the 2005 regular assessment from their policyholders.

In 2005, the company suffered losses of $1.3 billion as a result of hurricanes Katrina and Rita. In 2006, Citizens issued $978.205 million of bonds to pay for the losses. Under R.S. 22:2291, Citizens may assess up to 10% of state property premiums to pay the debt service on the bonds. The total statewide assessable premiums are approximately $2 billion. Because of the collections as noted below, the change in the balance of emergency assessment income is as follows:

2007	3.6% assessment rate	$78,012,088
2008	5.0% assessment rate	$103,646,244

Included in surplus as "funds restricted for debt service" is the excess of emergency assessments collected that were greater than debt service costs of $49,133,166 since the inception of the bond debt in 2006. This surplus amount can only be used to retire outstanding bond obligations.

9. CONTINGENCIES

Claims Related Extra Contractual Obligations and Bad Faith Losses Stemming From Lawsuits

Citizens paid the following amounts in the reporting period to settle claims related to extra contractual obligations (ECO) or bad faith claims stemming from lawsuits.

	Direct
Claims related ECO and bad faith losses paid during the reporting period	$20,000,000

Number of claims where amounts were paid to settle claims related ECO or bad faith claims resulting from lawsuits during the reporting period.

(a) 0 - 25 Claims	(b) 26 - 50 Claims	(c) 51 - 100 Claims	(d) 101 - 500 Claims	(e) More Than 500 Claims
				X

Claim count information is disclosed per claim or per claimant.

(f) Per Claim	(g) Per Claimant
	X

All Other Contingencies

Various lawsuits against Citizens have arisen in the course of Citizens business. Contingent liabilities arising from litigation and other matters are not considered material in relation to the financial position of Citizens. Citizens has no asset that it considers to be impaired.

10. LEASES

Lessee Operating Lease

Citizens leases office space at two separate locations, one in Metairie, Louisiana and one in Baton Rouge, Louisiana, under separate lease agreements that expire on October 31, 2010, and August 31, 2009, respectively. Rental expense for 2008 was approximately $371,990.

At January 1, 2009, the minimum aggregate rental commitments are as follows:

Year Ending December 31	Operating Leases
2009	$453,518
2010	310,520

Citizens is not involved in any material sales-leaseback transactions.

11. DIRECT PREMIUM WRITTEN/PRODUCED BY MANAGING GENERAL AGENTS/THIRD PARTY ADMINISTRATORS

Citizens' policies are sold and can be bound through any licensed agent in the State of Louisiana. From January 1 through September 30 of 2005, the underwriting and claims servicing was contracted and completed by Audubon Insurance Company. Effective on October 1, 2005, all new service providers are Bankers Insurance Group, First Premium Insurance Group, and MacNeill Group.

12. UNCOLLECTIBLE BALANCES FOR PREMIUM BALANCES

At December 31, 2008, Citizens has admitted assets of $22,400,107 in premiums receivable due from policyholders. Citizens routinely assesses the collectability of these receivables. An amount representing balances over 90 days has been established as a nonadmitted asset; at December 31, 2008, the amount of $270,726 represented such balances over 90 days due.

Prior to 2008, because of system limitations, Citizens was unable to produce a schedule of proper detail of aged balances. Citizens was able to look forward on future collections to determine the value of current receivables. The difference between this current balance and the ending receivable book balance became the nonadmitted asset. In 2008, Citizens was able to produce an aging schedule by policy; therefore, a more accurate aging schedule resulted. In this process change, Citizens wrote off $2,670,191 in premium receivable balances that exceeded the total receivable balance as determined in the new aging schedule.

13. REINSURANCE

Unsecured Reinsurance Recoverables

In 2008, Citizens incurred significant losses from Hurricane Gustav for which a recovery was filed as of December 31, 2008, to Citizens' reinsurance broker for recovery of losses sustained that exceeded the retention limit under the reinsurance contract. Citizens received the majority of payments for this recovery within the first 35 days of 2009. Letters of credit were requested at the same time as the reinsurance loss recoveries, thus the letters of credit from unauthorized reinsurers did not include the recovery of loss and loss expenses that were concurrently paid January 2009. To offset the unauthorized loss and loss expense recovery, Citizens has elected to list those payments received in 2009 as collateral against the recovery and report such payments as miscellaneous balances in the provision for unauthorized reinsurance. A listing of the remaining unsecured reinsurance recoverables at December 31, 2008, is as follows:

Federal Employer Identification Number	Name of Reinsurer	Amount
25-1149494	Lexington Insurance Co.	$360,853
AA-3190874	Amlin Bermuda Ltd.	165,743
AA-3190873	Ariel Reins Co. Ltd.	72,694
AA-1320035	AXA Re	967,695
AA-1464100	Converium AG Zurich	40,810
AA-3194122	Davinci Reinsurance Ltd.	91,281
AA-3194130	Endurance Specialty Ins Ltd.	2,688
AA-3190877	Flagstone Reinsurance Ltd.	108,081
AA-3190886	Harbor Point Re Ltd.	64,549
AA-3190875	Hiscox Ins Co (Bermuda) Ltd.	82,675
AA-0054166	Lehman Reinsurance Co. Ltd.	3,122,132
AA-3194129	Montpelier Reins Ltd.	13,285
AA-3190869	New Castle Reins Co Ltd.	13,426
AA-3194174	Platinum Underwriters Bermuda Ltd.	29,581
AA-3190339	Renaissance Reins Ltd.	103,887
AA-3190870	Validus Reinsurance Ltd.	103,762
Total unsecured reinsurance recoverables		$5,343,142

Reinsurance Ceded

The maximum amount of return commission that would have been due to nonaffiliated reinsurers if they or Citizens had cancelled all reinsurance is $3,405,456 which is computed by applying the ceding commission rate of 16% to the ceded unearned premium reserve of $21,284,099.

14. CHANGES IN INCURRED LOSSES AND LOSS ADJUSTMENT EXPENSES

Reserves as of December 31, 2008, were $371 million. As of December 31, 2008, $134 million has been paid for incurred losses and loss adjustment expenses attributed to insured events of prior years. Reserves remaining for prior years are now $137 million as a result of a re-estimation of unpaid claims and claim adjustment expenses. Therefore, there has been a $100 million favorable prior year development since December 31, 2007, to December 31, 2008. The decrease is generally the result of the estimated IBNR reserves where these open reserves are our current best estimate for future paid and we are anticipating far less development in the future. No return premiums have been accrued as a result of the prior-year effects.

15. RECONCILIATION OF SAP TO GAAP

Reconciliation of Citizens' 2008 statutory basis net income and accumulated surplus to its GAAP basis (as determined by the Governmental Accounting Standards Board) change in net assets and total net assets, respectively, is as follows:

	Year Ended December 31, 2008
Net income - Statutory basis	$6,106,794
Adjustments:	
Change in nonadmitted assets	6,406,802
Policy acquisition costs	(2,362,640)
Note issuance costs	(1,376,248)
Excess regular assessment recoupments	1,712,073
Tax exempt surcharge	8,470,948
Miscellaneous	(5)
Change in net assets - GAAP basis	$18,957,724

	Year Ended December 31, 2008
Accumulated surplus - Statutory basis	($4,098,074)
Adjustments:	
Nonadmitted capital assets, net	451,605
Nonadmitted prepaid health insurance	48,550
Provision for reinsurance (Schedule F Penalty)	5,343,142
Contributed surplus (Emergency Assessments)	(978,205,000)
Policy acquisition costs	11,238,178
Bond issuance costs	21,294,391
Miscellaneous	(8)
Total Net Assets - GAAP basis	($943,927,216)

Summary Investment Schedule (Unaudited)

Schedule of Investment Risk Interrogatories (Unaudited)

Schedule of General Interrogatories Related to Reinsurance (Unaudited)

SUMMARY INVESTMENT SCHEDULE

Investment Categories	Gross Investment Holdings 1 Amount	Gross Investment Holdings 2 Percentage	Admitted Assets as Reported in the Annual Statement 3 Amount	Admitted Assets as Reported in the Annual Statement 4 Percentage
1. Bonds:				
1.1 U.S. treasury securities	0	0.000	0	0.000
1.2 U.S. government agency obligations (excluding mortgage-backed securities):				
1.21 Issued by U.S. government agencies	0	0.000	0	0.000
1.22 Issued by U.S. government sponsored agencies	0	0.000	0	0.000
1.3 Foreign government (including Canada, excluding mortgaged-backed securities)	0	0.000	0	0.000
1.4 Securities issued by states, territories, and possessions and political subdivisions in the U.S.:				
1.41 States, territories and possessions general obligations	0	0.000	0	0.000
1.42 Political subdivisions of states, territories and possessions and political subdivisions general obligations	0	0.000	0	0.000
1.43 Revenue and assessment obligations	0	0.000	0	0.000
1.44 Industrial development and similar obligations	0	0.000	0	0.000
1.5 Mortgage-backed securities (includes residential and commercial MBS):				
1.51 Pass-through securities:				
1.511 Issued or guaranteed by GNMA	0	0.000	0	0.000
1.512 Issued or guaranteed by FNMA and FHLMC	0	0.000	0	0.000
1.513 All other	0	0.000	0	0.000
1.52 CMOs and REMICs:				
1.521 Issued or guaranteed by GNMA, FNMA, FHLMC or VA	0	0.000	0	0.000
1.522 Issued by non-U.S. Government issuers and collateralized by mortgage-backed securities issued or guaranteed by agencies shown in Line 1.521	0	0.000	0	0.000
1.523 All other	0	0.000	0	0.000
2. Other debt and other fixed income securities (excluding short-term):				
2.1 Unaffiliated domestic securities (includes credit tenant loans rated by the SVO)	0	0.000	0	0.000
2.2 Unaffiliated foreign securities	0	0.000	0	0.000
2.3 Affiliated securities	0	0.000	0	0.000
3. Equity interests:				
3.1 Investments in mutual funds	149,491,381	70.065	149,491,381	70.065
3.2 Preferred stocks:				
3.21 Affiliated	0	0.000	0	0.000
3.22 Unaffiliated	0	0.000	0	0.000
3.3 Publicly traded equity securities (excluding preferred stocks):				
3.31 Affiliated	0	0.000	0	0.000
3.32 Unaffiliated	0	0.000	0	0.000
3.4 Other equity securities:				
3.41 Affiliated	0	0.000	0	0.000
3.42 Unaffiliated	0	0.000	0	0.000
3.5 Other equity interests including tangible personal property under lease:				
3.51 Affiliated	0	0.000	0	0.000
3.52 Unaffiliated	0	0.000	0	0.000
4. Mortgage loans:				
4.1 Construction and land development	0	0.000	0	0.000
4.2 Agricultural	0	0.000	0	0.000
4.3 Single family residential properties	0	0.000	0	0.000
4.4 Multifamily residential properties	0	0.000	0	0.000
4.5 Commercial loans	0	0.000	0	0.000
4.6 Mezzanine real estate loans	0	0.000	0	0.000
5. Real estate investments:				
5.1 Property occupied by the company	0	0.000	0	0.000
5.2 Property held for the production of income (including $ 0 of property acquired in satisfaction of debt)	0	0.000	0	0.000
5.3 Property held for sale (including $ 0 property acquired in satisfaction of debt)	0	0.000	0	0.000
6. Contract loans	0	0.000	0	0.000
7. Receivables for securities	0	0.000	0	0.000
8. Cash, cash equivalents and short-term investments	63,868,431	29.935	63,868,431	29.935
9. Other invested assets	0	0.000	0	0.000
10. Total invested assets	213,359,812	100.000	213,359,812	100.000

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SUPPLEMENTAL EXHIBIT FOR THE YEAR 2008 OF THE Louisiana Citizens Property Insurance Corporation

SUPPLEMENTAL INVESTMENT RISKS INTERROGATORIES

For The Year Ended December 31, 2008

(To Be Filed by April 1)

OF The Louisiana Citizens Property Insurance Corporation

Address (City, State and Zip Code) Metairie, LA 70005

NAIC Group Code 0000 NAIC Company Code 00000 Employer's ID Number 68-0571166

The Investment Risks Interrogatories are to be filed by April 1. They are also to be included with the Audited Statutory Financial Statements.

Answer the following interrogatories by reporting the applicable U. S. dollar amounts and percentages of the reporting entity's total admitted assets held in that category of investments.

1. Reporting entity's total admitted assets as reported on Page 2 of this annual statement. $ 1,328,507,487
2. Ten largest exposures to a single issuer/borrower/investment.

	1 Issuer	2 Description of Exposure	3 Amount	4 Percentage of Total Admitted Assets
2.01	FEDERATED TREAS OBLIG FUND 398	Common Stock - Money Market Mutual Funds	$ 149,491,381	11.3 %
2.02	REPURCHASE AGREEMENT WITH SOCIETE	Short-Term Investments	$ 40,815,846	3.1 %
2.03			$ 0	0.0 %
2.04			$ 0	0.0 %
2.05			$ 0	0.0 %
2.06			$ 0	0.0 %
2.07			$ 0	0.0 %
2.08			$ 0	0.0 %
2.09			$ 0	0.0 %
2.10			$ 0	0.0 %

3. Amounts and percentages of the reporting entity's total admitted assets held in bonds and preferred stocks by NAIC rating.

	Bonds	1	2		Preferred Stocks	3	4
3.01	NAIC-1	$ 40,815,846	3.1 %	3.07	P/RP-1	$ 0	0.0 %
3.02	NAIC-2	$ 0	0.0 %	3.08	P/RP-2	$ 0	0.0 %
3.03	NAIC-3	$ 0	0.0 %	3.09	P/RP-3	$ 0	0.0 %
3.04	NAIC-4	$ 0	0.0 %	3.10	P/RP-4	$ 0	0.0 %
3.05	NAIC-5	$ 0	0.0 %	3.11	P/RP-5	$ 0	0.0 %
3.06	NAIC-6	$ 0	0.0 %	3.12	P/RP-6	$ 0	0.0 %

4. Assets held in foreign investments:

4.01 Are assets held in foreign investments less than 2.5% of the reporting entity's total admitted assets? Yes [ ] No [X]

4.02	Total admitted assets held in foreign investments	$ 0	0.0 %
4.03	Foreign-currency-denominated investments	$ 0	0.0 %
4.04	Insurance liabilities denominated in that same foreign currency	$ 0	0.0 %

If response to 4.01 above is yes, responses are not required for interrogatories 5 – 10.

SUPPLEMENTAL INVESTMENT RISKS INTERROGATORIES (cont.)

5. Aggregate foreign investment exposure categorized by NAIC sovereign rating:

		1	2
5.01	Countries rated NAIC-1	$ 0	0.0 %
5.02	Countries rated NAIC-2	$ 0	0.0 %
5.03	Countries rated NAIC-3 or below	$ 0	0.0 %

6. Largest foreign investment exposures by country, categorized by NAIC sovereign rating:

		1	2
	Countries rated NAIC-1:		
6.01	Country 1:	$ 0	0.0 %
6.02	Country 2:	$ 0	0.0 %
	Countries rated NAIC-2:		
6.03	Country 1:	$ 0	0.0 %
6.04	Country 2	$ 0	0.0 %
	Countries rated NAIC-3 or below:		
6.05	Country 1:	$ 0	0.0 %
6.06	Country 2:	$ 0	0.0 %

		1	2
7.	Aggregate unhedged foreign currency exposure	$ 0	0.0 %

8. Aggregate unhedged foreign currency exposure categorized by the country's NAIC sovereign rating:

		1	2
8.01	Countries rated NAIC-1	$ 0	0.0 %
8.02	Countries rated NAIC-2	$ 0	0.0 %
8.03	Countries rated NAIC-3 or below	$ 0	0.0 %

9. Largest unhedged foreign currency exposures by country, categorized by the country's NAIC sovereign rating:

		1	2
	Countries rated NAIC-1:		
9.01	Country:	$ 0	0.0 %
9.02	Country:	$ 0	0.0 %
	Countries rated NAIC-2:		
9.03	Country:	$ 0	0.0 %
9.04	Country:	$ 0	0.0 %
	Countries rated NAIC-3 or below:		
9.05	Country:	$ 0	0.0 %
9.06	Country:	$ 0	0.0 %

10. Ten largest non-sovereign (i.e. non-governmental) foreign issues:

	1 Issuer	2 NAIC Rating	3	4
10.01			$ 0	0.0 %
10.02			$ 0	0.0 %
10.03			$ 0	0.0 %
10.04			$ 0	0.0 %
10.05			$ 0	0.0 %
10.06			$ 0	0.0 %
10.07			$ 0	0.0 %
10.08			$ 0	0.0 %
10.09			$ 0	0.0 %
10.10			$ 0	0.0 %

SUPPLEMENTAL INVESTMENT RISKS INTERROGATORIES (cont.)

11. Amounts and percentages of the reporting entity's total admitted assets held in Canadian investments and unhedged Canadian currency exposure:

11.01 Are assets held in Canadian investments less than 2.5% of the reporting entity's total admitted assets? Yes [ ] No [X]

If response to 11.01 is yes, detail is not required for the remainder of Interrogatory 11

		1	2
11.02	Total admitted assets held in Canadian Investments	$ 0	0.0 %
11.03	Canadian-currency-denominated investments	$ 0	0.0 %
11.04	Canadian-denominated insurance liabilities	$ 0	0.0 %
11.05	Unhedged Canadian currency exposure	$ 0	0.0 %

12. Report aggregate amounts and percentages of the reporting entity's total admitted assets held in investments with contractual sales restrictions.

12.01 Are assets held in investments with contractual sales restrictions less than 2.5% of the reporting entity's total admitted assets? Yes [ ] No [X]

If response to 12.01 is yes, responses are not required for the remainder of Interrogatory 12.

	1	2	3
12.02	Aggregate statement value of investments with contractual sales restrictions	$ 0	0.0 %
	Largest 3 investments with contractual sales restrictions:		
12.03		$ 0	0.0 %
12.04		$ 0	0.0 %
12.05		$ 0	0.0 %

13. Amounts and percentages of admitted assets held in the ten largest equity interests:

13.01 Are assets held in equity interest less than 2.5% of the reporting entity's total admitted assets Yes [ ] No [X]

If response to 13.01 above is yes, responses are not required for the remainder of Interrogatory 13.

	1 Name of Issuer	2	3
13.02		$ 0	0.0 %
13.03		$ 0	0.0 %
13.04		$ 0	0.0 %
13.05		$ 0	0.0 %
13.06		$ 0	0.0 %
13.07		$ 0	0.0 %
13.08		$ 0	0.0 %
13.09		$ 0	0.0 %
13.10		$ 0	0.0 %
13.11		$ 0	0.0 %

SUPPLEMENTAL INVESTMENT RISKS INTERROGATORIES (cont.)

14. Amounts and percentages of the reporting entity's total admitted assets held in nonaffiliated, privately placed equities:

14.01 Are assets held in nonaffiliated, privately placed equities less than 2.5% of the reporting entity's total admitted assets? Yes [ ] No [X]

If response to 14.01 above is yes, responses are not required for the remainder of Interrogatory 14.

	1	2	3
14.02	Aggregate statement value of investments held in nonaffiliated, privately placed equities	$ 40,815,846	3.1 %
	Largest 3 investments held in nonaffiliated, privately placed equities:		
14.03	REPURCHASE AGREEMENT WITH SOCIETE	$ 40,815,846	3.1 %
14.04		$ 0	0.0 %
14.05		$ 0	0.0 %

15. Amounts and percentages of the reporting entity's total admitted assets held in general partnership interests:

15.01 Are assets held in general partnership interests less than 2.5% of the reporting entity's total admitted assets? Yes [ ] No [X]

If response to 15.01 is yes, responses are not required for the remainder of Interrogatory 15.

	1	2	3
15.02	Aggregate statement value of investments held in general partnership interests	$ 0	0.0 %
	Largest 3 investments with contractual sales restrictions:		
15.03		$ 0	0.0 %
15.04		$ 0	0.0 %
15.05		$ 0	0.0 %

16. Amounts and percentages of the reporting entity's total admitted assets held in mortgage loans:

16.01 Are mortgage loans reported in Schedule B less than 2.5% of the reporting entity's total admitted assets? Yes [ ] No [X]

If response to 16.01 above is yes, responses are not required for the remainder of Interrogatory 16 and Interrogatory 17.

	1 Type (Residential, Commercial, Agricultural)	2	3
16.02		$ 0	0.0 %
16.03		$ 0	0.0 %
16.04		$ 0	0.0 %
16.05		$ 0	0.0 %
16.06		$ 0	0.0 %
16.07		$ 0	0.0 %
16.08		$ 0	0.0 %
16.09		$ 0	0.0 %
16.10		$ 0	0.0 %
16.11		$ 0	0.0 %

SUPPLEMENTAL INVESTMENT RISKS INTERROGATORIES (cont.)

Amount and percentage of the reporting entity's total admitted assets held in the following categories of mortgage loans:

		Loans	
16.12	Construction Loans	$ 0	0.0 %
16.13	Mortgage loans over 90 days past due	$ 0	0.0 %
16.14	Mortgage loans in the process of foreclosure	$ 0	0.0 %
16.15	Mortgage loans foreclosed	$ 0	0.0 %
16.16	Restructured mortgage loans	$ 0	0.0 %

17. Aggregate mortgage loans having the following loan-to-value ratios as determined from the most current appraisal as of the annual statement date:

		Residential		Commercial		Agricultural	
	Loan-to-Value	1	2	3	4	5	6
17.01	above 95%	$ 0	0.0 %	$ 0	0.0 %	$ 0	0.0 %
17.02	91% to 95%	$ 0	0.0 %	$ 0	0.0 %	$ 0	0.0 %
17.03	81% to 90%	$ 0	0.0 %	$ 0	0.0 %	$ 0	0.0 %
17.04	71% to 80%	$ 0	0.0 %	$ 0	0.0 %	$ 0	0.0 %
17.05	below 70%	$ 0	0.0 %	$ 0	0.0 %	$ 0	0.0 %

18. Amounts and percentages of the reporting entity's total admitted assets held in each of the five largest investments in real estate:

18.01 Are assets held in real estate reported less than 2.5% of the reporting entity's total admitted assets? Yes [ ] No [X]

If response to 18.01 above is yes, responses are not required for the remainder of Interrogatory 18.

Largest five investments in any one parcel or group of contiguous parcels of real estate.

	Description 1	2	3
18.02		$ 0	0.0 %
18.03		$ 0	0.0 %
18.04		$ 0	0.0 %
18.05		$ 0	0.0 %
18.06		$ 0	0.0 %

19. Report aggregate amounts and percentages of the reporting entity's total admitted assets held in investments held in mezzanine real estate loans:

19.01 Are assets held in investments held in mezzanine real estate loans less than 2.5% of the reporting entity's total admitted assets? Yes [ ] No [X]

If response to 19.01 above is yes, responses are not required for the remainder of Interrogatory 19.

19.02 Aggregate statement value of investments held in mezzanine real estate loans: $ 0 0.0 %

Largest three investments held in mezzanine real estate loans:

	Description 1	2	3
19.03		$ 0	0.0 %
19.04		$ 0	0.0 %
19.05		$ 0	0.0 %

SUPPLEMENTAL INVESTMENT RISKS INTERROGATORIES (cont.)

20. Amounts and percentages of the reporting entity's total admitted assets subject to the following types of agreements:

	At Year-end 1	At Year-end 2	At End of Each Quarter: 1st Quarter 3	2nd Quarter 4	3rd Quarter 5
20.01 Securities lending agreements (do not include assets held as collateral for such transactions)	$ 0	0.0 %	$ 0	$ 0	$ 0
20.02 Repurchase agreements	$ 40,815,846	3.1 %	$ 86,584,827	$ 61,157,953	$ 53,089,982
20.03 Reverse repurchase agreements	$ 0	0.0 %	$ 0	$ 0	$ 0
20.04 Dollar repurchase agreements	$ 0	0.0 %	$ 0	$ 0	$ 0
20.05 Dollar reverse repurchase agreements	$ 0	0.0 %	$ 0	$ 0	$ 0

21. Amounts and percentages of the reporting entity's total admitted assets for warrants not attached to other financial instruments, options, caps, and floors:

	Owned 1	Owned 2	Written 3	Written 4
21.01 Hedging	$ 0	0.0 %	$ 0	0.0 %
21.02 Income generation	$ 0	0.0 %	$ 0	0.0 %
21.03 Other	$ 0	0.0 %	$ 0	0.0 %

22. Amounts and percentages of the reporting entity's total admitted assets of potential exposure for collars, swaps, and forwards:

	At Year-end 1	At Year-end 2	At End of Each Quarter: 1st Quarter 3	2nd Quarter 4	3rd Quarter 5
22.01 Hedging	$ 0	0.0 %	$ 0	$ 0	$ 0
22.02 Income generation	$ 0	0.0 %	$ 0	$ 0	$ 0
22.03 Replications	$ 0	0.0 %	$ 0	$ 0	$ 0
22.04 Other	$ 0	0.0 %	$ 0	$ 0	$ 0

23. Amounts and percentages of the reporting entity's total admitted assets of potential exposure for futures contracts:

	At Year-end 1	At Year-end 2	At End of Each Quarter: 1st Qtr 3	2nd Qtr 4	3rd Qtr 5
23.01 Hedging	$ 0	0.0 %	$ 0	$ 0	$ 0
23.02 Income generation	$ 0	0.0 %	$ 0	$ 0	$ 0
23.03 Replications	$ 0	0.0 %	$ 0	$ 0	$ 0
23.04 Other	$ 0	0.0 %	$ 0	$ 0	$ 0

GENERAL INTERROGATORIES

PART 2 - PROPERTY & CASUALTY INTERROGATORIES

6.1 What provision has this reporting entity made to protect itself from an excessive loss in the event of a catastrophe under a workers' compensation contract issued without limit of loss:
NOT APPLICABLE

6.2 Describe the method used to estimate this reporting entity's probable maximum insurance loss, and identify the type of insured exposures comprising that probable maximum loss, the locations of concentrations of those exposures and the external resources (such as consulting firms or computer software models), if any, used in the estimation process:
THE COMPANY USES RMS AND AIR CLASSIC CATASTROPHE MODELING SOFTWARE

6.3 What provision has this reporting entity made (such as a catastrophic reinsurance program) to protect itself from an excessive loss arising from the types and concentrations of insured exposures comprising its probable maximum property insurance loss?
THE COMPANY HAS OBTAINED A PROPERTY CATASTROPHE EXCESS OF LOSS CONTRACT TO COVER A 100/250 YEAR PML

6.4 Does the reporting entity carry catastrophe reinsurance protection for at least one reinstatement, in an amount sufficient to cover its estimated probable maximum loss attributable to a single loss event or occurrence? Yes [X] No [ ]

6.5 If no, describe any arrangements or mechanisms employed by the reporting entity to supplement its catastrophe reinsurance program or to hedge its exposure to unreinsured catastrophic loss.

7.1 Has the reporting entity reinsured any risk with any other entity under a quota share reinsurance contract that includes a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g., a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions)? Yes [ ] No [X]

7.2 If yes, indicate the number of reinsurance contracts containing such provisions. 0

7.3 If yes, does the amount of reinsurance credit taken reflect the reduction in quota share coverage caused by any applicable limiting provision(s)? Yes [ ] No [ ]

8.1 Has this reporting entity reinsured any risk with any other entity and agreed to release such entity from liability, in whole or in part, from any loss that may occur on the risk, or portion thereof, reinsured? Yes [ ] No [X]

8.2 If yes, give full information

9.1 Has the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:

(a) A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;

(b) A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;

(c) Aggregate stop loss reinsurance coverage;

(d) A unilateral right by either party (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions which are only triggered by a decline in the credit status of the other party;

(e) A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or

(f) Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity. Yes [ ] No [X]

9.2 Has the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates), for which, during the period covered by the statement, it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; excluding cessions to approved pooling agreements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member, where:

(a) The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or

(b) Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates in a separate reinsurance contract. Yes [ ] No [X]

9.3 If yes to 9.1 or 9.2, please provide the following information in the Reinsurance Summary Supplemental Filing for General Interrogatory 9:

(a) The aggregate financial statement impact gross of all such ceded reinsurance contracts on the balance sheet and statement of income;

(b) A summary of the reinsurance contract terms and indicate whether it applies to the contracts meeting the criteria in 9.1 or 9.2; and

(c) A brief discussion of management's principle objectives in entering into the reinsurance contract including the economic purpose to be achieved.

9.4 Except for transactions meeting the requirements of paragraph 30 of SSAP No. 62, Property and Casualty Reinsurance, has the reporting entity ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

(a) Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles ("SAP") and as a deposit under generally accepted accounting principles ("GAAP"); or

(b) Accounted for that contract as reinsurance under GAAP and as a deposit under SAP? Yes [ ] No [X]

9.5 If yes to 9.4, explain in the Reinsurance Summary Supplemental Filing for General Interrogatory 9 (Section D) why the contract(s) is treated differently for GAAP and SAP.

9.6 The reporting entity is exempt from the Reinsurance Attestation Supplement under one or more of the following criteria:

(a) The entity does not utilize reinsurance; or, Yes [ ] No [X]

(b) The entity only engages in a 100% quota share contract with an affiliate and the affiliated or lead company has filed an attestation supplement; or Yes [ ] No [X]

(c) The entity has no external cessions and only participates in an intercompany pool and the affiliated or lead company has filed an attestation supplement. Yes [ ] No [X]

10. If the reporting entity has assumed risks from another entity, there should be charged on account of such reinsurances a reserve equal to that which the original entity would have been required to charge had it retained the risks. Has this been done? Yes [ ] No [ ] N/A [X]

OTHER REPORT REQUIRED BY

GOVERNMENT AUDITING STANDARDS

The following pages contain a report on internal control over financial reporting, and on compliance with laws and regulations and other matters as required by *Government Auditing Standards*, issued by the Comptroller General of the United States. This report is based on the audits of the financial statements and includes, where appropriate, any significant deficiencies and/or material weaknesses in internal control or compliance and other matters that would be material to the presented financial statements.

LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA

February 2, 2010

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Statutory Basis Financial Statements

BOARD OF GOVERNORS OF THE
LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION
STATE OF LOUISIANA
Metairie, Louisiana

We were authorized by Louisiana Revised Statute 22:2306 to audit the statutory basis financial statement of admitted assets, liabilities, and accumulated surplus of the Louisiana Citizens Property Insurance Corporation (Citizens), a component unit of the State of Louisiana, as of December 31, 2008, and the related statutory basis statements of operations, changes in accumulated surplus, and cash flows for the year then ended, and have issued our report thereon dated February 2, 2010. Our audit was to have been conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. However, because of the inadequacies in Citizens' user access controls and other weaknesses in its computer systems, the lack of monitoring of the activities of Citizens and its service providers, the deficiencies in Citizens' processes to develop loss liabilities, receivables, and other financial statement information, and other matters as further discussed in this internal control and compliance report, we were limited in our ability to apply sufficient auditing procedures to enable us to apply the foregoing standards and, therefore, we were not able to express an opinion on the aforementioned financial statements.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered Citizens' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Citizens' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Citizens' internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed in Exhibit B, we identified deficiencies in internal control over financial reporting that we considered to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Citizens' ability to initiate, authorize, record, process, or report financial data reliably in accordance with the statutory basis of accounting described in our report on the statutory basis financial statements dated February 2, 2010, such that there is more than a remote likelihood that a misstatement of Citizens' financial statements that is more than inconsequential will not be prevented or detected by Citizens' internal control. We consider all of the deficiencies described in Exhibit B to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by Citizens' internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, because the control deficiencies described in Exhibit B are pervasive and interrelated, they are all considered to be material weaknesses. We did not audit Citizens' responses in Appendix A and, accordingly, we express no opinion on them.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Citizens' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, for the matters described in Exhibit B related to noncompliance with state eligibility requirements, the December 2008 rate-filing did not comply with state law, noncompliance with policy take-out program requirements, and inaccurate calculation of emergency assessments on premium changes.

OTHER REPORTS

On November 5, 2008, a compliance audit report titled *Louisiana Citizens Property Insurance Corporation* was issued by the Louisiana Legislative Auditor. The report presents the results of procedures performed on all of the expenses incurred by Mr. Terry Lisotta, former executive director, from December 2003 through December 2006. The report disclosed findings relating to alleged expenses that were not incurred, personal expenses, expenses with no documented business purposes, duplicated expenses, and fictitious receipts to support expenses that may not have been incurred.

On May 13, 2009, a performance audit report titled *Louisiana Citizens Property Insurance Corporation 2008 Rate-Filing* was issued by the Louisiana Legislative Auditor. The report disclosed that Citizens' December 2008 rate-filing did not comply with all aspects of state law and Citizens cannot ensure that its December 2008 rate-filing was actuarially justified.

On October 7, 2009, a financial audit report was issued on the Department of Insurance for the fiscal year ended June 30, 2008. That report disclosed that the Louisiana Citizens Property Insurance Corporation's 2007 residential rate-filing (excluding wind and hail-only coverage), which was submitted to the Louisiana Insurance Rating Commission (LIRC) in November 2007, was based on improperly adjusted data.

Those reports, including recommendations for improvement and management's responses, can be found at the Louisiana Legislative Auditor's Web site at www.lla.la.gov.

This report is intended solely for the information and use of the Board of Governors and management of Louisiana Citizens Property Insurance Corporation, the Louisiana Department of Insurance, and the Louisiana Legislature and is not intended to be, and should not be, used by anyone other than these specified parties. Under Louisiana Revised Statute 24:513, this report is distributed by the Legislative Auditor as a public document.

Respectfully submitted,

Daryl G. Purpera

Daryl G. Purpera, CPA
Temporary Legislative Auditor

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CITIZENS09

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Schedule of Findings and Recommendations

Lack of Controls Over Administering and Monitoring User Access

Louisiana Citizens Property Insurance Corporation (Citizens) granted employees and non-employees excessive, inappropriate access to the Louisiana Plans Management System (LPMS) and Fiserv, which allowed users the access to make changes to critical data, exposing Citizens to potential error and fraud. LPMS is used for maintaining insurance policies and claims processing. Fiserv is the general ledger system used for disbursements and financial statement preparation. Citizens lacked proper controls over the granting and termination of user IDs in its systems, lacked proper segregation of duties, and did not properly review and monitor accesses granted.

Good internal controls require segregation of duties to reduce the ability of a single individual to compromise a critical process. Also, personnel should perform only authorized duties relevant to their respective jobs and positions, and only appropriately authorized individuals should be granted access to system resources. In addition, when employees are transferred or terminated, their access privileges to system and application resources should be removed immediately.

Although it may be appropriate for a few designated employees to have "change" access to all data in a particular system, this level of access should be granted on a strict business-need-only basis and should be very tightly controlled and monitored. Most of the accesses listed below have been in place since October 2005.

<u>LPMS</u>

As of May 2009, 137 active user IDs were granted "Consultants-SBS" role in the LPMS database, allowing users the ability to make changes to any data in the system, including, but not limited to, policies, agents, claims, claim payments, percentage commissions paid to agents, policyholder addresses, billing history, and premium amounts received or owed.

Of the 137 user IDs with these broad access rights:

- 77 belonged to Citizens' employees;
- 15 could not initially be identified by Citizens; however, after several months Citizens identified seven (two Property Insurance Association of Louisiana (PIAL) employees, two PIAL employees who terminated, two Department of Insurance employees, and an American Insurance Association Board member) and labeled the other eight IDs as former Citizens' temporary employees;
- 22 were generic IDs;
- 14 belonged to the service providers Bankers Insurance Group and First Premium Insurance Group who are contractors assigned policies for underwriting and claims administration;

- 7 belonged to employees of PIAL, three of whom have terminated employment with PIAL; and

- 2 belonged to terminated Citizens' employees. At the test date, one employee had been terminated for nine months and the other for 12 months.

In addition, employees and nonemployees with LPMS user IDs were assigned the "SBS Consultants" job title that enables the user to approve claims over $25,000 using the LPMS claim approval screen. These included four unidentified users; one employee who does not have a valid business need; five generic user IDs; one terminated PIAL employee; and one service provider user.

We could not determine who had access to one generic user ID titled "Mail Clerk Claims" that was inappropriately assigned the "Claims Manager" job title and can approve claim payments totaling $25,000 or less and approve all loss adjustment expenses. This user ID has existed since January 2006.

<u>Fiserv</u>

Within Citizens' accounting section, job functions assigned and accesses granted to employees did not appropriately segregate the functions of authorization, data entry, generation, and review of disbursements. Because of excessive access granted to the Fiserv application, users were allowed access to make unauthorized changes to accounting data that included, but were not limited to, payee names, addresses, disbursement amounts, and journal entries. Of the 18 active user IDs:

- 14 had full administrative access allowing any change in the Fiserv system and 13 of the 14 also had full access to LPMS through the Consultants-SBS role, and

- 4 had profiles with rights to change vendors, claimants, and disbursement data and three of the four also had full access to LPMS through the Consultants-SBS role.

In addition, all 13 employees in the accounting section plus seven additional users had access to a shared directory on the network that gave them the ability to alter bank reconciliations and unencrypted batch files used to post payments and process disbursements.

Citizens' management allowed numerous users to work around LPMS malfunctions in the period surrounding hurricanes Katrina and Rita in 2005 by assigning the Consultants-SBS role, and thereafter continued to grant this access because of a lack of formal procedures and a limited technical knowledge of LPMS. Citizens has not adequately defined its security administrator function and has no formal written security policies and procedures for granting user IDs. In addition, Citizens does not have an adequate definition of authority and responsibility to use as a basis for defining security permissions and roles and for designing forms to be used to approve access rights.

Although Citizens has certain controls to detect unauthorized payments and errors, most of the users with these accesses granted could potentially bypass these controls undetected. Also, because Citizens does not monitor the logs in these systems for unauthorized activity, the risk of error or fraud increases for claim payments, adjustment of premiums, policy issuance, and bank and system reconciliations. Without formal procedures for granting and removing access rights, Citizens may be unable to effectively track, appropriately assign, and remove accesses for employees and nonemployees to prevent future unauthorized access.

Citizens' management should (1) review job descriptions to develop or identify appropriate system access profiles; (2) assign system and network accesses according to job function based on business need and classification of data; (3) create a detailed system access request form for use in granting and revoking access; (4) develop, implement, and follow appropriate access policies and procedures; (5) produce user access reports for supervisors to routinely search for inappropriate access; and (6) consider minimizing or eliminating the use of the Consultants-SBS role. Management concurred in part with the finding. Management concurred that the Consultants-SBS role was too broad and noted that all but three users have been eliminated. In addition, management provided that Fiserv job descriptions and needs have been reviewed and access has been reduced (see Appendix A, page 1).

Additional Comments: Given the broad accesses granted to user IDs and the lack of system monitoring controls, neither Citizens nor the auditors could support management's assertion that it has never had any unauthorized access or changes made to programs or data in its systems.

Lack of Monitoring Over Service Providers

Citizens did not perform adequate monitoring or internal audits on the procedures, controls, and transactions processed at the three service providers that it used to perform insurance policy administration and the related claims services for policyholders. Citizens also did not obtain Type II, Statement on Auditing Standards (SAS) 70 reports on its service providers. Good internal controls require an entity to monitor, review, test, and evaluate the transactions controlled or affected by its service providers to ensure data integrity, completeness, and accuracy. One means of gaining assurance on the controls within a service organization is through Type II, SAS 70 reports.

SAS 70: *Service Organizations* is an auditing statement issued by the American Institute of Certified Public Accountants (AICPA). Service organizations are typically entities that provide outsourcing services that impact the control environment of the company using the service. Citizens had contracts with three service providers in 2008 to provide policy administration and policyholder claims-related services. SAS 70 provides guidance to service auditors when assessing the internal controls of a service organization and issuing a service auditor's report. SAS 70 also provides guidance to auditors of financial statements of an entity that uses one or more service organization. A Type II service auditor's report, as per SAS 70, includes the service auditor's opinion on the fairness of the presentation of the service organization's description of controls that had been placed in operation and the suitability of the design of the controls to achieve the specified control objectives; and whether the specific controls were operating effectively during the period under review. The contracts between Citizens and its service providers do not require that the service providers obtain Type II, SAS 70 reports.

Citizens' employees were not required by internal policy to review transactions in amounts less than the Service Provider Authority Threshold, which include general claims under $25,000 and catastrophic claims up to $75,000. The claims that were less than the service provider's authority threshold comprised 60,547 out of 61,229 claims (99%) in 2008. The lack of review and approval of these transactions by Citizens' employees increases the risk that there may be errors or fraudulent activity related to claims loss payments within the service provider's authority threshold amounts and could result in misstatements to the financial statements. This risk emphasizes the need for monitoring of the service centers.

Although the contracts with the service providers do not require Type II, SAS 70 reports, the contracts do provide that Citizens can perform operational audits at the service centers. Citizens did not conduct operational audits of the service centers in 2008. Although Citizens did contract for some review services in 2009 after the fiscal year under audit, those procedures were not an adequate substitute for obtaining Type II, SAS 70 reports on the service providers.

Citizens placed its faith in the performance of the service providers without externally monitoring that performance. Failure to perform sufficient operational audits or to obtain SAS 70, Type II reports on each of its service providers results in the inability to ensure that procedures and controls are being applied in accordance with Citizens' intentions and regulations and increases the risk that contract terms are not being followed, which could result in errors, overpayments, financial misstatements, or fraud.

Management should institute controls to monitor, review, internally audit, and evaluate the performance of its service providers. Citizens should prepare, sign, and enforce contracts with all service providers that clearly define Citizens expectations from its service providers and require Type II, SAS 70 audits from those service providers. Management concurred in part with the finding. Management concurred that Type II, SAS 70 reports were not obtained on the service providers, but noted that Type I, SAS 70 reports were available for two service providers and operational reviews were conducted in 2007, 2008, and 2009 (see Appendix A, page 2).

Additional Comments: Type II, SAS 70 reports were not obtained and operational reviews were not performed in the year under audit, 2008.

In response to our requests for copies of all SAS 70 audits, Citizens' management provided one Type I, SAS 70 report on BinTech Partners, Inc., which according to Citizens' management is wholly owned and one of the new companies under Bankers Insurance Group (a Citizens' service provider). We were not informed of or provided a second Type I, SAS 70 report.

In the Type I report we were given, the service auditor noted that he did not perform procedures to determine the operating effectiveness of controls for any period and expresses no opinion on the operating effectiveness of any aspects of BinTech's controls. His opinion addressed the "description of controls." A Type I, SAS 70 report does not provide Citizens' management with assurance that service providers' controls are operating effectively. Considering the extent of the transactions processed by service providers that are also not reviewed or approved by Citizens' employees, this lack of assurance is critical.

Our review and testing of Citizens' procedures provided no evidence to support management's assertion that monitoring procedures at the service centers were in place for 2008. The examples of operational reviews provided by management included a follow-up by the service provider itself for concerns Citizens determined in 2007, and two chartered property casualty underwriter's reports on limited procedures performed on the three service providers.

One chartered property casualty underwriter's report was related to two service providers and described limited procedures that included samples of 16 Hurricane Gustav claims for one provider and 29 claims from the other provider to review "claim performance." The report described claims handling capabilities and performance but provided no assurances to Citizens' management regarding the operating effectiveness of service providers' controls.

The other report related to the third service provider and described limited procedures that included a sample of 45 claims to review performance and to identify and assess any unresolved claim exposure. While this report related to performance measurement against best claims practices, the purpose of the report was not to provide assurances relating to the operating effectiveness of service provider's controls, as would be the case in a Type II, SAS 70 audit.

Inadequate Loss Reserve Development Process

Citizens does not have an adequate process to develop loss and loss adjustment expense (LAE) reserve liabilities. Citizens is required to estimate the ultimate cost of settling insurance claims, including costs related to claims that were incurred but not reported, using past experience adjusted for current trends. Management is responsible for its estimates and the implementation of controls to ensure that the data used in deriving these estimates are complete and accurate. Citizens engages an outside actuary to assist in the estimation of the loss and LAE reserve liabilities based on data provided by Citizens.

Although an unfavorable judgment of $95 million was issued to Citizens on March 20, 2009, on a class action suit related to prior years' hurricane claims, there was no evidence that Citizens made any provision in the reserve amount for this case or other pending class action suits and mass joinders. The appointed actuary's Statement of Actuarial Opinion as of December 31, 2008, noted that the loss reserves carried by Citizens do not include provision for possible unfavorable outcomes concerning four pending class action suits and 16 mass joinders against Citizens. The actuary's opinion states, in part, "The scope of my opinion does not include any provisions for these (or possible future) class action suits and mass joinders. Therefore, my opinion is qualified in this regard." In addition, during tests of loss claims and loss reserves, auditors did not find any items within the recorded reserves tested that made provision for amounts related to these class action suits and mass joinders.

Audit procedures identified various errors and deficiencies in the data that was relied on by the appointed actuary to develop the estimate of reserves at December 31, 2008, as follows:

1. Case basis loss reserves related to system claims do not appear to include all appropriate amounts at year-end. Auditors ran a query on loss payments issued in the first three months of 2009 related to claims with (1) a loss occurrence date prior to the end of 2008; (2) a loss report date prior to the end of 2008; and (3) no reserve amount in the outstanding claim register. This procedure identified 4,257 payments totaling approximately $23 million. A review of the transactions identified errors indicating that case basis loss reserves did not include all appropriate claims at December 31, 2008. Specific errors included:

    - Reserves associated with several claims appear to have been closed out as a result of advance (partial) payments coded as "final" payments in the claims system.

    - Reserves were not reestablished for claims with payments that were issued and voided prior to year-end and were reissued subsequent to year-end.

    - Reserve balances were not established for certain claims although documentation in the claim file at December 31, 2008, indicated that the amount of the loss was known.

    - Amounts related to off-system, manually processed claims were excluded from direct case basis loss reserves for all accident years. At December 31, 2008, these amounts were approximately $2.8 million for case basis loss reserves and approximately $60,000 for LAE reserves.

2. Case basis loss reserve balances included approximately $1.4 million on claims that were closed and had no loss reserves as of December 31, 2008.

3. Citizens did not appropriately classify paid LAE and LAE case reserves as defense and cost containment (DCC) expenses or adjusting and other (A&O) in accordance with Statement of Statutory Accounting Principle (SSAP) No. 55. As a result, DCC paid and case basis reserve data relied on by the appointed actuary is inaccurate.

4. During a review of case reserves related to litigated claims, the following discrepancies between reserves recorded by Citizens and the value of the loss represented to the auditors by Citizens' outside legal counsel were identified:

   - One claim with a recorded reserve at December 31, 2008, of $220,000 was settled in 2007 and therefore should not have had a reserve balance at December 31, 2008.

   - Two claims with recorded reserves of $16,000 had probable outcomes estimated in the range of $700,000 and $1.3 million based on information from legal counsel.

   - Seven claims with total recorded reserves at December 31, 2008, of approximately $2 million were settled or tentatively settled in 2009 for approximately $334,000. Citizens' recorded reserves for these seven cases ranged from $206,000 to $450,000 per claim, and the settlement (or tentative settlement) amounts ranged from $5,000 to $130,000 per claim.

   - Four claims with total recorded reserves of $1.2 million had probable outcomes estimated in the range of $290,000 to $400,000 based on information from legal counsel.

These conditions are the result of inadequacies in Citizens' information systems and inadequate procedures to ensure that loss information is complete and accurate. Furthermore, Citizens is not timely updating case reserves to reflect the best available information. Failure to maintain accurate and complete information related to losses and loss adjustment expenses hampers the estimation process and increases the risk of material misstatement of liabilities and expenses reported in the financial statements.

Management should establish an adequate process to develop and report estimated liabilities for losses and loss adjustment expenses. This process should include formal procedures to identify and fully compensate for inadequacies in Citizens' information system that affect the data used to develop the estimate of loss and LAE reserves. In addition, Citizens should provide for the timely update of reserves to reflect the most complete and accurate available information. Management did not concur with the finding and noted that the Loss and LAE reserves of $170 million were in the range of a detailed analysis conducted by the contracted actuarial firm. Management stated, in part, that (1) the payments were made after the reserves were established and the reserve is always different than the payment; (2) there have always been manual commercial claims without case reserves included in the overall reserve process; (3) the DCC and A&O classifications relate to timing; (4) the items mentioned in 4. in the finding are very small misclassifications; and (5) lawyers do not set reserves for insurance companies (see Appendix A, pages 3-4).

Additional Comments: Auditing standards require auditors to obtain and evaluate sufficient appropriate audit evidence to support significant accounting estimates. Reviewing transactions and events subsequent to the financial statement date are included among the procedures prescribed by the auditing standards for auditors to use in evaluating management's estimates.

The loss and LAE reserves reported in the financial statements are an estimate of the future payments for claims related to insurable events that have occurred as of the balance sheet date. These liabilities include provisions for claims that have been reported as of the balance sheet date (case basis reserves) and provisions for claims that have not yet been reported as of the balance sheet date (incurred but not reported reserves). The ultimate reserve liabilities reported in the financial statements are actuarial estimates based on historical loss and loss adjustment expense development adjusted for current trends. In 2008, an independent actuary was engaged to assist in the estimation of the reserve liabilities.

In the Actuarial Report on *Unpaid Claim and Claim Expense Estimates* as of December 31, 2008, the independent actuary stated, in part, that the actuarial firm relied upon the accuracy of the Citizens' data provided for their analysis and if the data is inaccurate or incomplete, their estimates may need to be revised.

The independent actuary represented that he relied on Citizens' case basis loss reserve and paid loss data to determine loss development factors and that he applied these development factors to Citizens' case basis loss reserves and paid loss data to derive the estimate of loss reserves reported in the financial statements. Because case basis loss reserves and paid loss data are significant to the estimate of loss reserves, we performed procedures to determine whether case basis loss reserves and paid loss data were reasonably complete and accurate. The conditions identified in our finding demonstrate deficiencies and inaccuracies in the data relied upon by the actuary.

Regarding class action lawsuits, management asserts that the "settlement of the *Orrill* class, by law, eliminates the other classes" and therefore the settlement and IBNR reserves are adequate for the outcomes related to class action suits. Based on our review of the existing information on the cases, management's assertion is incorrect. There are different plaintiffs in the cases in different parishes and different outcomes may occur. In March 2009, a trial court granted the plaintiff's motions for summary judgment filed in December 2008 stipulating monetary damages in excess of $92.8 million in the *Oubre* case.

Regarding numbered items in management's response:

1. It is a common and prudent practice for auditors to determine the reasonableness of accounting estimates and estimation methods by comparing the estimate to actual results. Although we do not consider the $23 million at-risk population identified in our test work to be a known error, we do consider such a large population to indicate that case loss reserves are most likely incomplete. Moreover, management states that ". . . many insurers do not develop case reserves; instead, they use bulk or factor reserves." We acknowledge that it is an acceptable practice in the industry to use other methods when statistical analysis indicates that the ultimate development of the original reserves will be lacking. However, management does not use this methodology.

2. Regarding the exclusion of off-system, manually processed commercial claims, management asserts that these amounts are included in the IBNR portion of loss reserves. While payments related to manually processed commercial claims are

included in paid loss development data submitted to the actuary, unpaid amounts related to manually processed claims are excluded from case basis loss reserves that are submitted to the actuary. Since the actuary considered case basis loss reserves to be significant to his estimate of the ultimate loss liability, we consider this condition to be an example of an inadequate process to prepare and submit critical data to the actuary.

3. Management asserts that the inclusion of reserve amounts related to claims that were closed as of December 31, 2008 ". . . is a typical situation that relates to timing . . ." However, this statement directly conflicts with actions taken by management to correct this condition. In February and March of 2009, Citizens investigated each of these claims to determine whether the claims were actually closed at December 31, 2008. According to management, the results of this undertaking indicated that substantially all of these claims should not have had a reserve balance as of December 31, 2008, and the reserves on these claims were subsequently closed in March 2009. While management contends that this condition is "typical," it seems unlikely that such corrective actions would have been taken if this were the case. Because this condition represents an inaccuracy in data that was significant to the actuary's reserve estimate, we consider this evidence that management's process needs revision.

4. Regarding the misclassification of loss adjustment expenses, we believe that this error provides further evidence to indicate that management's process is inadequate. SSAP No. 55, *Unpaid Claims, Losses and Loss Adjustment Expense*, requires insurers to classify loss adjustment expenses as either defense and cost containment (DCC) expenses or adjusting and other (A&O) expenses. The actuary relies on both paid and case reserve DCC to derive his estimate of loss adjustment expense reserves. Citizens' information system does not have the capability to provide for these classifications in accordance with SSAP No. 55. Given this system limitation and the absence of other compensating controls, we believe this to be a deficiency in management's process to submit complete and accurate data to the actuary.

5. Management states that outside legal counsel is not responsible for Citizens' reserve-setting process. This process is management's responsibility. However, for accurate results communication should routinely occur among service providers, Citizens' staff, outside counsel, and actuarial consultants when reserves are established and adjusted. Based on our audit procedures, we believe management's current process is insufficient. At any time, case basis reserves should reflect the best information available, including information from outside legal counsel.

In a 2007 Louisiana Legislative Auditor Performance Audit Division report, it was noted that reserves were not adjusted in a regular and consistent manner. In many cases, the reserves were increased immediately before payment and decreased immediately after payment. Reserves should reflect the most timely and relevant information to date.

Noncompliance With State Eligibility Requirements

Citizens did not follow state law to ensure that all applicants were eligible to be insured by Citizens. Louisiana Revised Statute (R.S.) 22:2302(A) provides that any person having an insurable interest in insurable property and who has been denied coverage by one or more insurers authorized to write property insurance in this state is eligible to apply for insurance through Citizens directly or through a representative. R.S. 22:2302(A) further provides that every application form shall require that the applicant disclose each insurance carrier who denied property insurance coverage to the applicant.

During our test of direct written premiums, 35 applications for policies written in 2008 were reviewed. Of these 35 applications, 34 (97%) did not disclose on the application that the applicant was denied coverage or list each insurance carrier who denied property insurance coverage to the applicant. "No" was checked on the applications for the question "Has insurance been cancelled, declined, or non-renewed in the voluntary market?"

Management expressed that it did not have the means to implement a control to ensure compliance with this provision. Failure to ensure that all policyholders are eligible to be insured by Citizens causes Citizens to be in noncompliance with state law and could result in policies being issued to ineligible applicants, which could lead to payment of losses to an ineligible insured. This also increases the risk of misstatement of premiums earned and claim losses on the financial statements. In addition, the legislation creating Citizens explicitly states that the legislature intends for Citizens to work to reduce the number of policy holders until Citizens is no longer needed. If Citizens issues coverage to those who could get coverage elsewhere, then legislative intent for Citizens to be the insurer of last resort would not be met.

Management should ensure that policies are issued only to those applicants whose application information demonstrates eligibility for coverage as prescribed by state law. Management concurred with the finding and provided that the new policy management system that will be installed in the spring of 2010 will prohibit the issuance of new policies to property owners who have not been denied coverage by another company (see Appendix A, page 5).

Uncertainty in Premiums Receivable

Citizens did not adequately support premiums receivable. Citizens could not provide an accurate and complete aging of premiums receivable, and the results of our tests indicate an uncertainty of the premiums receivable (uncollected premiums) balance at December 31, 2008. Good business practices require that accurate and complete financial records be maintained to ensure that the amounts recorded in the financial statements are materially correct.

Citizens uses its LPMS to process and record premium transactions. However, because of the limitations and unreliability of LPMS, Citizens contracted with a computer consultant to design the Louisiana Citizens Data Mart (Datamart) as a method of obtaining data from LPMS. Datamart reports are used to create the manual general ledger entries to generate financial reports. The aging of uncollected premiums was also determined using the Datamart. Management reported admitted premiums receivable of approximately $23.4 million.

During our testing of admitted uncollected premiums at December 31, 2008, 24 transactions totaling $413,313 were examined. For seven of 24 (29%) transactions tested, the premium balance outstanding at December 31, 2008, was overstated in total by $309,508. Upon further evaluation of the exceptions, the following deficiencies were noted:

- In five exceptions noted above, all or part of the premium payments totaling $225,636 were removed (suppressed) from the receivables balance. While generating the aging of premiums receivable, the computer consultant erroneously removed premium payments thought to be duplicate payments. A total of $960,345 in premiums payments were removed from the premiums receivable balance, which resulted in an overstatement to premiums receivable of $960,345. The monies were appropriately deposited into Citizens' accounts.

- In two exceptions, the premium balance in the aging report was incorrect and there should have been no balance (zero) at December 31, 2008. The computer consultant generates the aging report by pulling the balance from the LPMS policy balance table. When a change is made to the premium amount via an endorsement, LPMS does not process the amounts correctly in the policy balance table, which Datamart uses to create the aging report. Auditors could not determine why LPMS is calculating the amounts incorrectly in the table and therefore cannot determine the extent of the misstatement.

- For one exception, the balance in the aging report was incorrect; the balance should have been zero at December 31, 2008. When a renewal policy cancels before the effective date of the policy, Citizens refunds the entire premium and fees paid by the applicant. However, for such an event, the emergency assessment fee does not zero out in the LPMS policy balance table, which results in a false receivable in the amount of the emergency assessment fee. In each case, the receivable amount should be zero. Based upon the available information, auditors could not determine the extent of the misstatement.

Failure to maintain an accurate and complete aging of premiums receivable has resulted in an uncertainty of the premiums receivable balance reported on the financial statements at December 31, 2008. This increases the risk of material misstatement of premiums receivable on the financial statements.

Management should resolve system errors and/or establish control procedures to provide an accurate and complete aging of premiums receivable and eliminate the uncertainty of the premiums receivable (uncollected premiums) balance at year-end caused by system problems. Management did not concur with the finding, but acknowledged that there are some issues in the LPMS that impact premiums receivable balances. Management expressed that the $960,345 was corrected; the incorrect balances in the aging report had minimal impact; and the emergency assessment differences were only $220,000 (see Appendix A, page 6).

Additional Comments: Management reported admitted premiums receivable of approximately $23.4 million. Our sample identified a 29% error rate. Further evaluation of the exceptions identified inaccuracies in how the receivable balance was determined. With a high sample error rate and the nature of the problems we found, it is likely that additional errors exist and would have significantly higher dollar impact for the whole population.

In regard to the error resulting in false receivables, Citizens' management noted that the differences have been quantified to be approximately $220,000. However, supporting documentation for this amount shows that the amount is netted between negative and positive receivables and includes additional errors not quantified in our finding.

December 2008 Rate-Filing Did Not Comply With State Law

Citizens' December 2008 rate-filing did not comply with all requirements in state law. R.S. 22:2303 prescribes the requirements for the board's role in rate setting; the commissioner of insurance's role in rate-setting; the frequency of rate changes; the noncompetitive nature of the rates; and the actuarial requirements of the rates. Citizens' rates are not intended to compete with private insurance company rates and must be at least 10% higher than those of the largest insurers with certain exemptions.

As described in the Performance Audit Division's report *Louisiana Citizens Property Insurance Corporation 2008 Rate-Filing* issued May 13, 2009, several aspects of law were not complied with in the December 2008 rate-filing. In October 2008, Citizens submitted a rate-filing to the commissioner requesting an overall average rate increase of 13.7%.

Citizens paid approximately $104,000 for an actuarial consultant to assist in its rate determination and used that information in its initial rate-filing. The commissioner notified Citizens' management that he would not approve the actuarially indicated rates because of pervasive data integrity issues and other deficiencies in the actuarial analysis. Then, without board approval, Citizens' staff submitted a revised rate-filing with a lower average rate increase of 7%, which was then approved by the commissioner and subsequently approved by the board. Since the board did not pre-approve the formulas used by Citizens' staff in setting the revised rates, the board did not fulfill its statutory duty of adopting rate-setting formulas before determining rates.

Citizens used the market survey conducted by the Department of Insurance in setting its rates without evaluating the responses from the surveyed companies. Consequently, Citizens could not have determined if the information was reliable. Because the actuarial information was not used and the survey responses were not evaluated, this process may have inappropriately resulted in noncompetitive rates in noncompliance with state law.

As recommended in the Performance Audit, the Citizens board should vote to adopt rate-setting formulas before determining rates. Citizens' management should perform its own market survey for future rate-filings or obtain and evaluate survey responses from the Department of Insurance if the department does the survey. Citizens should ensure that its rate-filings are actuarially justified as required by law to further ensure they remain noncompetitive. Management concurred in part with our finding noting that it agreed the Citizens board needed to review and approve rates and rating formulas before their effective date. Citizens' management disagreed that the commissioner disapproved the actuarial data because of "pervasive data integrity issues," and provided that instead, the commissioner's disapproval was that the data was unaudited at that time (see Appendix A, page 7).

Additional Comments: In a letter dated December 4, 2008, to Mr. John Wortman, CEO, regarding Citizens' FAIR and Coastal Plans residential rate revision, the commissioner of insurance included, in part, the following statements:

> With regard to the actuarial concerns, there are two categories that have been identified by my actuarial staff. The first actuarial category of concern identifies pervasive data integrity issues underlying the filing's entire actuarial analysis. The second actuarial category of concern deals with specific actuarial methods and assumptions.
>
> The pervasive data integrity issues are significant and overriding to the entire actuarial analysis presented in this filing.
>
> The second category of actuarial concerns, though not as pervasive as the data integrity issue, is significant to the actuarial analysis that determines the rates by parish for each program.
>
> However, without reliable historical data and supporting actuarial analysis, my staff and I are unable to validate or agree with LCPIC's actuarial calculations and assumptions set forth in this rate filing.

The overall statewide rate change for residential programs was approved based on the market survey data.

Noncompliance With Policy Take-Out Program Requirements

Citizens did not comply with the requirements of R.S. 22:2314 regarding the required depopulation of Citizens' policies referred to as the Policy Take-Out Program. R.S. 22:2314 provides that the legislature created Citizens to operate insurance plans as a residual market for residential and commercial property and intends that Citizens work toward the ultimate depopulation of these residual market plans. The Policy Take-Out Program was developed to encourage the depopulation. The statute requires that at least once per calendar year, Citizens shall offer policies for removal to the voluntary market in bundles of at least 500 policies, which include both Coastal and FAIR Plan policies. Citizens shall include policies in the bundle with geographic and risk characteristics that serve to reduce the exposure of the corporation. Each insurer in Louisiana admitted to write residential or commercial policies who desires to participate must submit a take-out plan to Citizens. An insurer shall not be qualified to submit a take-out plan unless that insurer is admitted to write homeowners or commercial insurance in the state of Louisiana. Citizens must submit the plans to the Louisiana Department of Insurance (DOI) for review and approval. If the plan is approved by DOI, Citizens shall submit the plan to its board. The Citizens board shall develop guidelines for the program and file these with the Senate and House committees on Insurance and the commissioner of insurance for approval.

Citizens conducted two rounds of depopulation in 2008, resulting in seven Take-Out companies assuming 39,936 of approximately 170,000 policies (23%). Those policies represented approximately $68 million out of approximately $260 million in premiums (26%), which followed the policies, also reducing Citizens' exposure by an estimated $9 billion.

In testing compliance with R.S. 22:2314, we identified the following noncompliance and weaknesses:

- Citizens offered the total population of in-force policies for take-out but did not bundle them in any way. Instead, the Take-Out companies were given a database of the policies and allowed to selectively determine the policies each company wanted to assume. Citizens then contacted the insurance agents, or producers, to obtain approval to assume those policies. Consequently, Citizens failed to comply with specific bundle criteria outlined in the revised statute that included offering policies in bundles that represented the geographical and risk characteristics of its overall population of policies.

- Although 75,683 (45%) of Citizens' in-force policies had been selected by Take-Out companies, only 39,936 (53%) of those policies were actually depopulated. Citizens interpreted R.S. 22:23 (Exclusive use of expirations) to mean that a policy could not be depopulated unless authorized by the insurance agent. This interpretation may have caused a lesser number of policies to be depopulated since R.S. 22:2314 has no language requiring an insurance agent's authorization.

- Citizens did not collect and submit to DOI any formal Take-Out plans from interested insurance companies as required by R.S. 22:2314. Compliance with this requirement would have ensured that all seven companies that participated in the two rounds of depopulation would have met the eligibility criteria described in the statute. As a result, one company that was not admitted to write policies in Louisiana and another company that did not have a financial rating were allowed to participate and assume 12,382 (31%) of the 39,936 policies.

- The Citizens board did not prepare and submit guidelines for the Take-Out Program to the Senate and House committees on insurance and the commissioner of insurance for approval.

Citizens' management believes that there is a statutory conflict between R.S. 22:23 and R.S. 22.2314 and performed the depopulation process by complying with the latter criteria that could be reasonably met while complying with the constraints required by R.S. 22:23. In addition, management noted that compliance with the bundling requirement could have resulted in none of the bundles being selected since each bundle would likely include "unwanted" policies. However, since R.S. 22:2314 is specific legislation related to Citizens-only, there is no statutory language in R.S. 22:2314 cross referencing R.S. 22:23, and R.S. 22:2314 is a more recent expression of the legislative will, the latest statute would prevail.

The fiscal impact of Citizens' noncompliance with statutory requirements and the resulting effect on premium revenues, claim expenses, and exposure cannot be determined because the number of policies that would have been depopulated if Citizens complied with R.S. 22:2314 is unknown. In addition, failure to have Take-Out plans approved by DOI increases the risk that ineligible companies may be allowed to participate and that these companies could potentially find themselves unable to meet their obligations to the insurance agent or to the policyholder. Also, failure to submit required Take-Out Program guidelines to the commissioner of insurance and the legislature means that there is no written documentation of approval for the procedures followed by Citizens.

Management should review its implementation of the Policy Take-Out Program and develop formal practices that would ensure compliance with all the requirements specified in R.S. 22:2314 to meet the latest expression of legislative intent. Management concurred in part with the finding. Management acknowledged that two ineligible companies were allowed to participate in the Policy Take-Out Program in 2008. However, management believes that R.S. 22:23 does apply and there is a statutory conflict between R.S. 22:23 and R.S. 22:2314 (see Appendix A, pages 8-9).

Additional Comments: Citizens did not follow R.S. 22:2314, which represents specific legislation related to Citizens and is the latest expression of the legislature's will. As a result, Citizens is in noncompliance with state law.

Inaccurate Calculation of Emergency Assessments on Premium Changes

Citizens did not adjust the emergency assessment surcharge on its policies accurately and in compliance with R.S. 22:2301(E). This statute requires that upon changes to a policy of insurance during the term of the policy that results in an increase or decrease in premium, the emergency assessment is to be adjusted and the amount the insurer shall owe or be owed is to be computed on a pro rata basis for the term of the policy. Citizens is required to levy an emergency assessment surcharge on policies written. The amount collected is a uniform, statewide percentage that is determined annually and approved by DOI. For 2008, this was 5% of the total written premiums.

Citizens did not update its LPMS until February 2009 to properly reflect the changes in statute that were effective January 1, 2008. Citizens' noncompliance with R.S. 22:2301(E) has resulted in policyholders not being charged or refunded emergency assessment amounts on policy premium changes. Because of LPMS limitations, auditors could not determine the amount of the financial misstatement caused by the noncompliance.

Management noted that it became aware mid-2008 that the system was not making the proper emergency assessment adjustments. However, because of the complicated nature of the calculations, the volume of transactions, and the LPMS limitations, management was not able to make any overall retrospective changes to correct the problem. Because Citizens did not update its system in 2008, Citizens placed the burden on the policyholders to discover and seek correction of the emergency assessment amount for their policies.

Management should ensure the calculation and monitoring procedures over emergency assessments result in emergency assessment surcharges that are accurate and in compliance with state law. Management concurred in part to the finding. Management acknowledged that system issues regarding emergency assessments remained in LPMS until corrected in early 2009, but believes the impact of the error is approximately $220,000 (see Appendix A, page 10).

Additional Comments: Citizens' estimate of the approximate error amount of $220,000 does not relate to the problems identified in the finding. The $220,000 is a net amount that was derived from renewal policies that were cancelled before the effective date of the policy. This finding relates to policies with changes to premiums during the term of the policy. We could not determine the extent of the error.

Lack of an Internal Audit Function

Citizens did not have an effective internal audit function in place to examine, evaluate, and report on its internal controls, including information systems, and to evaluate compliance with the policies and procedures that comprise internal controls. An effective internal audit function is an independent appraisal activity within an entity for the review of accounting, financial, and other operations. The overall objective is to carry out a program of tests of the financial and operational activities and transactions to provide management with information about the effectiveness (and efficiency) of established accounting and operational policies, procedures and controls, and the extent to which they are being followed. Another objective is the prevention and detection of fraud through the performance of internal audit tests and procedures.

Management did not establish the internal audit function as a priority in 2008. An effective internal audit function could assist Citizens in the following areas: (1) developing and testing information technology controls; (2) establishing and testing financial reporting controls; (3) testing compliance with applicable laws and regulations; (4) monitoring service providers; and (5) identifying significant risk areas. Failure to establish an internal audit function increases the risk that Citizens' assets are not safeguarded and its policies and procedures are not uniformly applied.

Management should establish an effective internal audit function to ensure that assets are safeguarded and that management's policies, procedures, and controls are applied consistently in accordance with management's intentions. Management concurred in part with the finding. Management noted that Citizens has made progress in developing formal written policies and procedures and internal controls and will continue to examine the benefits of a formal internal audit function (see Appendix A, page 11).

Inadequate Program/System Change Controls

Citizens lacks adequate control over changes to its information technology (IT) programs and systems. Good internal controls would require that management monitor change requests to IT system applications and ensure that program changes are properly evaluated, prioritized, authorized, documented, monitored, and tested prior to implementation. In addition, the roles, tasks, and responsibilities of service providers and customers should be defined; logs of all program/system changes should be maintained; and program changes should be moved into production only when approved by management and persons independent of the programmer.

Audit procedures identified the following:

- Citizens has not properly segregated duties over changes to programs and systems and has not provided proper oversight and review of these changes. The two vendors who maintain the LPMS, Operational Reporting and Balancing System (ORBS), and Datamart have the ability to make changes to source code and data and can have those changes moved into production without Citizens' knowledge.

- Citizens does not have formal, documented procedures in place to ensure that all changes to its systems and data are authorized, prioritized, planned, tested, reviewed, and approved prior to moving into the production environment.

- Citizens and its vendors do not adequately document reported problems and related system changes and do not close all problems or change orders with documented evidence of resolution.

Citizens has not placed sufficient emphasis on the creation, documentation, and enforcement of formal change control procedures. The lack of program/system change controls increases the risk that vendors may make unauthorized, erroneous, malicious, or fraudulent changes to programs or data and move those changes to production without Citizens' knowledge; data errors and system downtime may occur because of inadequate planning, testing, and review of changes; and changes to systems, programs, or data may not be known, understood, or reparable by anyone except the person making the change. In addition, without current contractual agreements, Citizens is unable to require these vendors to follow formal policies and procedures.

Citizens' management should implement procedures to ensure changes made to key programs and systems are appropriately authorized, prioritized, planned, developed, tested, reviewed, approved, and documented. In addition, management should require complete documentation of all reported problems and change requests, monitor the progress, and ensure timely and documented evidence of resolution. Management responded that all program changes are reviewed, tested, and approved before changes are made to the system; there were no unauthorized changes; and the LPMS policy management system does not provide adequate requirements for separation of duties (see Appendix A, page 12).

Additional Comments: Our review and testing of Citizens' procedures provided no evidence to support management's assertion that all program changes are reviewed, tested, and approved by Citizens.

If unauthorized changes have occurred, the lack of monitoring, inadequate segregation of duties, inadequate access controls, and lack of documentation would not allow for their detection. Therefore, Citizens' management cannot support its statement that there have been no such occurrences of unauthorized program changes.

Our review of the security capabilities within LPMS indicated that the system could support adequate requirements for separation of duties if Citizens' management dedicated adequate resources to properly configure the system.

Inadequate Controls for Securing and Monitoring Systems

Citizens has not implemented appropriate controls for securing and monitoring its systems. Good internal controls include policies for application security and availability requirements in response to identified risks; performing security monitoring and periodic testing to minimize and identify security weaknesses and incidents, as well as evaluating their potential impact; and developing and maintaining password requirements that would improve security over its systems.

Audit procedures identified the following weaknesses:

- Citizens has not configured its systems to ensure that login requirements for LPMS, Fiserv, and its internal network are adequately complex to help prevent inappropriate access. In addition, Citizens has not prohibited the sharing of user IDs and passwords.

- Citizens has not formally determined what data should be classified as sensitive and has not protected such data by using accepted security techniques.

- Citizens has not appropriately granted and monitored remote access to its internal network. No formal process exists for authorizing remote access, which leads to the lack of an audit trail.

- Citizens has not monitored logs within LPMS or Fiserv for unauthorized access to its systems or unauthorized changes to key financial data.

- Citizens has not implemented a security awareness program that would inform and train users regarding current information security risks.

Citizens' management has not placed sufficient emphasis on information security. Citizens has not committed resources to sufficiently manage password changes, monitor its networks, and identify and protect sensitive data. Without proper controls for securing and monitoring its systems, Citizens' systems may be susceptible to unauthorized access and changes, as well as theft or destruction of Citizens' data without detection. In addition, management may not be able to hold users accountable for unauthorized use of an ID.

Citizens' management should require that passwords for all systems meet industry standards for complexity, expiration, and login attempts and disallow the sharing of user IDs. Management should also establish a data classification policy to identify and protect sensitive data; ensure remote access is appropriately authorized and monitored; review access log reports for both Fiserv and LPMS on a regular basis to search for inappropriate or unauthorized changes to data; and implement a security administration function. Management described corrective action plans relating to implementing a new, more complex systems access process, adding levels of security to remote access and publishing formal written IT security policies. Management stated that Citizens does not capture sensitive policyholder data. It also expressed that remote access was limited to senior management and technical support (see Appendix A, page 13).

Additional Comments: Our review of Citizens' data shows that it does contain sensitive information.

Citizens could not provide evidence to support its statement that remote access to its systems was limited to only senior management and technical support.

Logs are not a means of controlling access to systems. Logs are a key detective control in which history is maintained for monitoring system activity. Because Citizens does not actively monitor access logs for unauthorized activity, Citizens cannot timely detect unauthorized transactions. Furthermore, without adequate controls and monitoring, neither Citizens nor the auditor can assert whether or not there were any unauthorized accesses or changes to data in Citizens' systems.

Lack of Contracts for Information Technology Services

Citizens did not have contracts in place during 2008 for services rendered by information technology vendors, I.T. By Design (ITBD) and I4 Integrated Services (I4). Citizens paid ITBD approximately $2.5 million and I4 approximately $558,000 for services between January 2008 and May 2009 without contracts for either vendor.

Good business practices, including those governing information technology, require contract expenditures to be paid based on the terms and conditions of an approved, written contract. In addition, the roles, responsibilities, and expectations between the contracting parties should be well-defined, and a process should be established to monitor service delivery to ensure that the vendor is meeting current business requirements and that performance is acceptable. Contracts with service organizations should include provisions to require the vendors to provide reports on policies and procedures placed in operation and tests of operating effectiveness in accordance with SAS No. 70 (SAS 70, Type II report).

Citizens did not take adequate measures to ensure that information technology service contracts were current and applicable to the ongoing business at Citizens after its separation from the Property Insurance Association of Louisiana (PIAL). The lack of contracts with information technology vendors prevents Citizens from measuring/monitoring the services provided by the vendors with deliverables included in a defined, agreed-upon service agreement. The lack of an agreement increases the risk that the vendor may make unauthorized changes to systems and data that are not in accordance with a mutually understood agreement. This further allows the vendors to have less accountability and exposes Citizens to a lack of recourse if vendors do not perform or perform improperly.

Citizens' management should develop written contracts with all of its information technology vendors and include a clause requiring a SAS 70, Type II report when the vendor is a service organization. Management noted that a valid contract was in place in 2008 for I4 and that ITBD was honoring and working with Citizens under the original PIAL contract (see Appendix A, page 14).

Additional Comments: Citizens had no current contract with I4 during 2008 and early 2009 to continue ongoing financial support services. The contract with I4 in effect in 2008 was to support the compilation of financial statements for previous years, and the contract had no provision for processing 2008 transactions or for the preparation of 2008 financial statements.

The contract between PIAL and ITBD is not a valid contract between Citizens and ITBD. In addition, the services provided to PIAL according to the terms of that contract are not the same services provided to Citizens. For example, the Statement of Work in the PIAL contract addresses the implementation and maintenance of only PIAL's "network" and has no provision for ITBD's continued support of the LPMS "application."

Without valid contracts, Citizens exposes itself to a lack of recourse if vendors do not perform or perform improperly and reduces vendor accountability.

Inadequate Documentation of Information Systems

Citizens does not have adequate current documentation on the design and functions of its critical IT systems. The IT systems were developed by vendors specifically for Citizens, including the LPMS, Datamart, and ORBS. In addition, Citizens' management and personnel are critically dependent on vendors to manage, operate, and maintain LPMS and Datamart because of a lack of knowledge transfer between the vendors and Citizens. LPMS is Citizens' main system for supporting its insurance operations. Citizens uses the vendor-developed Datamart as a method of obtaining data from LPMS to develop its manual general ledger entries. ORBS is another vendor-developed system used by Citizens to independently balance and reconcile LPMS data to the Datamart.

Although Citizens is very dependent on its vendors for its IT systems, the vendors were not required to obtain SAS 70 (service organization) audits to provide Citizens with some assurance that adequate controls were in place for those contractors. In fact, management did not have current contracts with these vendors. The primary vendor maintaining LPMS has refused to sign a contract. Efforts to sign a contract with this vendor only appear to have been made after the auditor brought the issue to Citizens' attention. The lack of current contracts means that the vendors could abruptly stop providing services and Citizens would not be able to manage its own data.

Control and management objectives over IT systems require that software should be developed in accordance with design specifications, development and documentation standards, quality assurance requirements, and approval standards and that a management plan should be implemented and include documentation of the roles, responsibilities, procedures, documentation requirements, appropriate systems documentation, and guidance that is appropriate for personnel with varying levels of skills and experience. Also, critical reliance on vendors for basic system knowledge should be minimized.

Citizens' staff could not provide the auditors with updated or complete documentation of LPMS, Datamart, and/or ORBS, which are key systems relied on for internal control over financial reporting. Citizens has no process in place with regard to the production of user documentation, operations manuals, and training material for LPMS, Datamart, or ORBS. Also, there are no current data dictionaries for LPMS or Datamart on hand.

- The technical LPMS manual provided to the auditor has been a "draft" version since 2005 with no evidence of management review, edit, or approval. In addition, Citizens lacked current documentation explaining security roles and profiles and their appropriate assignments to users in LPMS.

- The original documentation given to the auditor for the Datamart consisted of a "Process Flow Diagram" flowchart that was over 1½ years old. The flowchart did not represent the current configuration of the Datamart for 2008.

- The ORBS executive and project overviews and related database table schematics do not accurately portray the current use of the ORBS database.

Citizens has not adequately trained its IT personnel to manage, operate, and maintain LPMS or Datamart without substantial vendor assistance. The lack of documentation and knowledge of its own systems, as well as no contracts, leaves Citizens vulnerable to losing control and availability for those information systems in the event a vendor no longer agrees to provide services to Citizens.

Without proper system documentation and knowledge, Citizens may be unable to determine the nature of data, IT controls, or programs that are critical for its financial reporting needs. As a result, the IT function may not adequately support the financial reporting process and financial reporting errors could likely occur and remain undetected.

Without proper system documentation and knowledge, especially on highly customized systems such as these, systems are subject to errors because:

- Certain control points and specific tables/data are not identified.

- Risk assessments and vulnerability assessments have not been adequately performed.

- A transfer of knowledge and training has not occurred.

- Output and reports are not sufficiently defined.

- Security roles, profiles, and their appropriate assignments to users have not been clearly interpreted or maintained.

- Data could be manipulated without management's knowledge by both the vendor and Citizens' staff who have inappropriate access.

Citizens' management should develop a process and dedicate the necessary internal resources for maintaining up-to-date system documentation, such as operation manuals, training materials, data dictionaries, and other documentation. Management should also provide training to its personnel sufficient to keep LPMS and Datamart operational in the event vendors no longer provide their services. Citizens' management should ensure its vendors maintain proper internal controls and current, detailed documentation on all systems and related changes. This documentation should be readily available to necessary Citizens' personnel, auditors, and other appropriate individuals. Current contracts should be obtained for all vendors and SAS 70, Type II audits should be required for all vendors who are service organizations. Management concurred that system documentation was inadequate. Management expressed that it would not be prudent to use Citizens' personnel to document systems that are scheduled to be replaced (see Appendix A, page 15).

Additional Comments: Because LPMS will be used until 2011, management's lack of documentation of its information systems creates a risk that system errors could occur and remain undetected and/or unresolved. In addition, without proper documentation, the knowledge and understanding of Citizens' personnel of its own systems is hampered.

At the onset of the audit, we asked for all contractual agreements. Management did not inform us of any ongoing negotiations with ITBD, a vendor that provides critical services. In late July 2009, Citizens' personnel provided us a "DRAFT" of a proposed contract, which remained unsigned in November 2009.

The documentation supporting the Datamart was outdated and inadequate for use in gaining an in-depth understanding of the Datamart's current system configuration.

Lack of Information Technology Policies and Procedures

During 2008, Citizens lacked the following policies and procedures concerning its use of IT:

- A logical access policy with standardized procedures for the issuance, revocation, and periodic review of system and network user IDs

- A physical access security policy

- A policy that classifies data for confidentiality, integrity, availability, and retention requirements

- An acceptable usage policy defining appropriate business use

- A network policy and "remote access" policy for granting outside users access to the internal network

- A policy for IT procurement

According to *Control Objectives for Information and Related Technology* published by the IT Governance Institute, entities should:

- Develop and communicate policies and procedures to ensure the achievement of IT objectives and awareness of business and IT risks.

- Establish and maintain IT security roles and responsibilities.

- Establish data ownership, define appropriate security levels and protection controls, and define data retention and destruction requirements.

- Develop and follow a set of procedures that is consistent with the organization's overall procurement process to acquire needed IT-related infrastructure, hardware, software, and services.

Management has not placed sufficient emphasis on the creation and enforcement of IT policies and procedures. Without appropriate IT policies and procedures, there is an increased risk that management (1) may grant inappropriate access to its systems, data, and physical assets; (2) is not effectively managing and safeguarding the confidentiality, integrity, and availability of data; and (3) may not timely and cost-efficiently acquire IT services and/or equipment. In addition, inadequate IT policies and procedures could also result in a lack of recourse if a negative event would occur.

Citizens' management should develop, implement, and follow appropriate IT policies and procedures and make them available to appropriate Citizens' personnel. Management expressed that Citizens does have IT policies and procedures and is in the process of strengthening and documenting those IT policies and procedures (see Appendix A, page 16).

Additional Comments: Citizens' personnel neither provided us with formalized IT policies and procedures nor were its informal policies clear and consistently applied.

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Management's Corrective Action Plans and Responses to the Findings and Recommendations

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Thursday, November 19, 2009

Steve J. Theriot, CPA
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State of Louisiana
1600 North Third Street
Post Office Box 94397
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Re: Louisiana Citizens Property Insurance Corporation Response to Legislative Audit November 11, 2009 Letter - Audit Finding: Lack of Controls for Over Administering and Monitoring User Access

Dear Mr. Theriot:

LPMS - LCPIC agrees that the Consulting - SBS role is too broad and has eliminated all but three users for which two have new limitations for correcting policies. Three of the user names are needed for systems administration purposes (backups, LPMS system and CatLoss). Additionally, although the Consulting – SBS ID's were "valid", many did not have sign-on capabilities.

It is important to note that although we are taking measures to increase our system controls, LCPIC has never had any unauthorized access or changes made to our systems noted by LCPIC IT or the Legislative auditors.

Fiserv - Job descriptions and needs have been reviewed and access has been reduced to four people with full access and five people with limited access.

As has been well documented, due to system problems and the aftermath of the 2005 storms, in mid 2008 LCPIC still had not been able to complete financials for the years 2005, 2006, and 2007. One of the biggest issues that prohibited the completion of the financials was the reconcilement of bank accounts for the thousands of checks written after the 2005 storms. External consultants as well as all available internal personnel were provided system access to help reconcile the bank accounts.

As part of the new system installation, LCPIC has established a role for system administrator and will develop written policies regarding system access by the first quarter of 2010.

Sincerely,

John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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Friday December 11, 2009

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Re: Louisiana Citizens Property Insurance Corporation (LCPIC) Response to Legislative Audit December 6, 2009 Letter - Audit Finding: Lack of Monitoring Over Service Providers

Dear Mr. Purpera:

LCPIC concurs in part with the finding. LCPIC does not have SAS 70 Type II reports from service providers contracted during 2008. The service provider selection process initiated in 2004, and administered through the Louisiana Office of State Purchasing, did not require audited financial statements or SAS 70 reports. This continued to be true in the 2009 Louisiana procurement process and was not a requirement for the 2009 service provider selection process. During 2008, all service providers were required to provide audited financial statements and two of the service providers, those with out of state administrative capability and not impaired by hurricanes Gustav and Ike, provided or had available for review SAS Type I reports.

LCPIC operating procedures include ongoing reviews of general and catastrophe claim files. LCPIC has procedures in place to perform operational reviews of service providers and performance requirements continue to be strengthened. Operational reviews were initiated in 2007, and reviews were conducted in 2007, 2008 and 2009. Operational reviews were conducted by Citizens staff and independent review staff, during this review period. Examples are attached.

LCPIC fully concurs with the need for continuous improvement and accountability in service provider controls and presented revised comprehensive claim and underwriting reviews to the LCPIC Board of Directors in August of 2009 (attached).

Sincerely,

John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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Tuesday December 15, 2009

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1600 North Third Street
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Re: Louisiana Citizens Property Insurance Corporation (LCPIC) Response to Legislative Audit November 30, 2009 Letter - Audit Finding: Inadequate Loss Reserve Development Process

Dear Mr. Purpera:

LCPIC absolutely does not concur with this finding. It is clear the auditor does not understand property casualty insurance reserving practices. Most of the information cited by the auditor is based on information only available after the fact. The auditor does not understand the development and purpose of the "incurred but not reported" portion of loss reserves. The auditor does not understand claim handling and the reserving process and is asserting misinformation despite many explanations. It is clear the examination was of individual pieces without understanding the entire process. The result is a waste of time and effort.

Regarding class action law suits, at 12/31/08, LCPIC had a settlement of the Orrill class and had $20 million on file with the court. This was reflected in the 2008 financials. The settlement of the Orrill class, by law, eliminates the other classes. This was the LCPIC position at the end of 2008, and continues to be the position as LCPIC goes through the appeal process. Evidence to this effect was provided to the auditors. LCPIC believes the case and IBNR reserves are adequate to settle all other pending suits and claims.

Regarding specific points raised:

1. This demonstrates a complete lack of understanding of claim handling and the establishment of case reserves. First, the payments were made after the end of 2008, so this is information that clearly was not available at year end 2008. The claim process is meant to pay claims and case reserves are adjusted according to company guidelines. The reserve is always different than the final payment. In fact, many insurance companies do not develop case reserves, instead, they use bulk or factor reserves.

The three bullet points listed by the auditor are typical of any insurance company operation and do not have an impact on the overall reserve process. This was explained to the auditors many times.

2. The reserves listed are included in the "Incurred but not Reported" portion of the overall loss reserves. There have always been manual commercial claims without case reserves. These are included in the payment patterns and are included in the overall actuarial reserve process.

3. This is a typical situation that relates to timing and again reflects the auditor's lack of knowledge of property and casualty claim and reserve practices.

4. This is a misclassification of a very small amount. It has no impact on the accuracy of the overall reserving process.

5. Lawyers do not set reserves for insurance companies. Again, this reflects the auditor's lack of understanding of the property and casualty reserving process. This information was obtained from the lawyers eleven (11) months after the fact and has no impact on the overall 2008 reserve calculation. As explained to the auditor many times, and as this finding demonstrates, after the fact, some cases close below the case reserve and some cases close above the case reserve.

In conclusion, LCPIC totally disagrees with the audit finding that LCPIC information systems and claim reserve procedures are inadequate to insure complete and accurate loss information. At the end of 2008, LCPIC had net Loss and LAE reserves of $170 million which was in the range of a detailed analysis conducted by an independent outside property and casualty actuarial firm.

Sincerely,

J John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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Friday December 11, 2009

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Re: Louisiana Citizens Property Insurance Corporation (LCPIC) Response to Legislative Audit November 30, 2009 Letter - Audit Finding: Noncompliance with State Eligibility Requirements

Dear Mr. Purpera:

LCPIC concurs with this finding. The LPMS policy management system does not provide the capability to monitor the denial of coverage requirement for new policies, or the capability to restrict agents from selling polices to people without evidence of denial.

The new policy management system that will be installed in the spring of 2010 will prohibit the issuance of new policies to property owners that have not been denied coverage by another insurance company.

Sincerely,

John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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Friday December 11, 2009

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Re: Louisiana Citizens Property Insurance Corporation (LCPIC) Response to Legislative Audit November 30, 2009 Letter - Audit Finding: Uncertainty in Premiums Receivable

Dear Mr. Purpera:

LCPIC does not concur with the wording of "uncertainty" in this finding. There are some issues within the LPMS system that impact premium receivable balances. Although the issues increase the difficulty of reconciling premium receivable, the impacts have been quantified and have minimal impact on overall receivable balances. Three were noted in the finding.

The first exception noted totaled $960,345 and was corrected in March of 2009.

The second exception noted impacted 850 out of 140,000 policies and has minimal dollar value. Any adjustments required will be made to our accounts receivable balance.

The final exception noted relates to another finding regarding the over/under collection of Emergency Assessments. The LPMS system did not make adjustments to Emergency Assessments receivable for changes made to policies in 2008. The differences have been quantified to be approximately $220,000. A balance sheet adjustment will be made between accounts receivable and accounts payable to correct this issue.

Sincerely,

John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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Monday December 7, 2009

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1600 North Third Street
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Re: Louisiana Citizens Property Insurance Corporation Response to Legislative Audit November 20, 2009 Letter - Audit Finding: December 2008 Rate-Filing Did Not Comply With State Law

Dear Mr. Purpera:

As stated in our response to the Rate-Filing Audit conducted by your office dated May 13, 2009, LCPIC concurs in part to the findings noted in the audit. We agree that the Citizens Board needs to review and approve rates and rating formulas prior to their effective date. However, in our response to the May 13, 2009 audit, we noted that we do not believe the Statute specifies an order for the approvals required from the Department of Insurance and our Board of Directors. In this case, we received approval from our Board of Directors three months prior to the implementation of the noted rate changes.

We disagree with the statement in your finding that "the Commissioner notified Citizens management that he would not approve the actuarially indicated rates because of pervasive data integrity issues" in the actuarial analysis. The issue the Commissioner's office had with our historic data was that at the time of the rate filing, the audits of our historical financial data had not been completed. The Commissioner's concern was using unaudited data in the actuarial analysis - not that we had "pervasive data integrity issues". In fact, the completed audits found no issues with our financial data. Since audited historical data was not available for the actuarial analysis, it was deemed that the market data should be relied upon for the rate analysis.

Citizens used the market survey data collected by the Department of Insurance because there was not enough time for Citizens to collect our own market data before the rate analysis was due.

We agree that Citizens should collect the market data for all future rate increases and have done so for the actuarial and rate analysis that is currently under way. A formal presentation was made to the LCPIC Board of Directors on August 13, 2009 on the rate making process. We also agree that the Citizens Board should not only approve any rate changes, but also the rate formulas that drive the rate changes.

Sincerely,

John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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Friday December 11, 2009

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Re: Louisiana Citizens Property Insurance Corporation (LCPIC) Response to Legislative Audit December 6, 2009 Letter - Audit Finding: Noncompliance with Policy Take-Out Program Requirements

Dear Mr. Purpera:

LCPIC concurs in part with this finding. LCPIC acknowledges that one non-admitted company and one company that did not have a rating were allowed to participate in the take out process in 2008.

However, LCPIC's process ensures that all statutory requirements are met to the greatest extent possible, without compromising compliance with LRS 22:23. Ultimately, LCPIC believes the process complies with the intent of LRS 22:2314. The objective of the LCPIC depopulation program is to allow the maximum number of policies to be depopulated.

With regard to the requirement that policies be bundled in groups of not less than 500 policies, note that all active policies were offered for depopulation in one large bundle of over 500 policies reflecting the geographical and risk characteristics of the overall book of business. This approach was chosen to comply with LRS 22:23, which gives the agent of record the ultimate authority to authorize the movement of a policy to a take-out company. If LCPIC were to select the policies assumed by each insurer, it would be a violation of that statute. LCPIC firmly believes that LRS 22:23 does apply and that, in this respect, there is a statutory conflict between LRS 22:23 and LRS 22:2314. LCPIC will work with the State Legislature to amend the take-out legislation in order to avoid any statutory conflicts.

The 75,683 policies referenced in the finding, includes policies requested by multiple companies. There were 60,000 unique polices requested and of those, the agents authorized 39,936 (66%) for transfer to the take out companies.

The LCPIC Board of Directors has formally approved the Depopulation process. Additionally, during each round of Depopulation, the Board members are advised on a monthly basis as to the names and number of companies participating, the policies requested, and the policies authorized to each company by the agent of record.

The Depopulation process has been extremely successful for the state of Louisiana. In 2008, LCPIC reduced its policy base by 40,000 policies (25% of its book of business), reducing the total insured value of the company be approximately $9 billion, thereby reducing the risk of future assessments to all property insurance policyholders in the state.

Sincerely,

John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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Friday December 11, 2009

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Re: Louisiana Citizens Property Insurance Corporation (LCPIC) Response to Legislative Audit December 9, 2009 Letter - Audit Finding: Inaccurate Calculation of Emergency Assessment on Premium Changes

Dear Mr. Purpera:

LCPIC concurs in part with this finding. In 2007, a change was made to the LPMS system to charge the required 5% Emergency Assessment on all new and renewal polices in 2008. A systems change was also made to refund Emergency Assessments when policies were cancelled flat. However, systems issues remained within the LPMS system for recalculating Emergency Assessments for changes made to existing policies. These issues were corrected in early 2009.

The impact of the Emergency Assessment calculation error was quantified to be approximately $220,000. All Emergency Assessments collected were remitted to the bond trustee, even if they were in error, as required by statute.

Sincerely,

John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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Friday December 11, 2009

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1600 North Third Street
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Re: Louisiana Citizens Property Insurance Corporation (LCPIC) Response to Legislative Audit December 6, 2009 Letter - Audit Finding: Lack of an Internal Audit Function

Dear Mr. Purpera:

LCPIC concurs in part with this finding. While LCPIC does not have an official internal audit function, LCPIC has made great progress in developing formal written policies and procedures and internal controls. Prior to April 1, 2008, LCPIC outsourced all management functions to Property Insurance Association of Louisiana (PIAL). LCPIC officially assumed all management functions on April 1, 2008. LCPIC hired an executive management team that was tasked with solving significant operational issues. In addition, LCPIC managed 55,000 Gustav/IKE storm claims in 2008. As a part of the solution to the operational issues the current management team inherited, LCPIC developed and documented multiple operational processes and internal control procedures in 2008.

LCPIC believes the development and documentation of formal processes and procedures and internal controls, has provided an internal audit aspect for the company. However, in order to improve operational and internal controls in 2010, LCPIC will develop and execute specific tests of company operational and internal controls.

LCPIC will continue to examine the benefits of hiring personnel for a formal internal audit function with the costs that ultimately are paid by the property insurance policy holders of the state.

Sincerely,

John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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November 9, 2009

Steve J. Theriot, CPA
Louisiana Legislative Auditor
1600 North Third Street
P.O. Box 94397
Baton Rouge, LA 70804-9397

Dear Mr. Theriot:

Please find our responses to the audit findings noted below:

<u>Audit Finding: Inadequate Program/System Change Controls</u>

Our process is that all program changes are reviewed, tested, and approved before changes are made to the system.

While many things fall into the category of "may be possible", including unauthorized program changes, any unauthorized changes would create system issues and or questions that would be immediately investigated. Although unauthorized program changes are theoretically possible, there have been no such occurrences.

The LPMS policy management system does not provide adequate requirements for separation of duties; however, we are in the process of replacing this old system before the end of 2010. Our new policy management system will require adequate separation of duties.

Sincerely,

John Wortman

J. John Wortman
CEO
Louisiana Citizens Property Insurance Corporation

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Thursday, November 19, 2009

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Baton Rouge, Louisiana 70804-9397

Re: Louisiana Citizens Property Insurance Corporation Response to Legislative Audit November 6, 2009 Letter - Audit Finding: Inadequate Controls for Securing and Monitoring Systems

Dear Mr. Theriot:

LCPIC believes the lack of system access complexity is compensated by requirements to have multiple sign-ons to access our systems. However, we are in the process of implementing a new, more complex systems access process that will be completed in the first quarter of 2010. Implementation was impacted by the time it took to move from the old PIAL domain to the Citizens domain (official separation was in 4/08). Generic names have been removed.

All financial data sent to outside vendors is encrypted. LCPIC does <u>not</u> capture sensitive policyholder data such as social security numbers or bank account information.

Remote access is limited to a small group of users (senior management and technical support). In the first quarter of 2010 we will eliminate VPN (remote access) and move to terminal services which will add additional levels of security.

LCPIC believes there are many ways to control system access other than logs. Our systems access and the ability to make changes is controlled via access parameters as noted above. All transactions leave an audit trail and record the user. There have been no known instances found of unauthorized system access or changes noted by either LCPIC or by the auditors.

Formal written IT security policies will be published to all users during the first quarter of 2010.

Sincerely,

John Wortman

J. John Wortman, CEO

C: Steve Cottrell, CFO

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November 9, 2009

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Baton Rouge, LA 70804-9397

Dear Mr. Theriot:

Please find our responses to the audit findings noted below:

Audit Finding: Lack of Contracts for Information Technology Services

LCPIC has a valid contract with I4 that was signed on December 6, 2007 and was in effect in 2008.

Our primary usage of the vendor IT By Design (ITBD) is for maintenance of our LPMS policy management system. ITBD had a written agreement for services with PIAL prior to April of 2008 when LCPIC formally split from PIAL. Although the formal contract with ITBD was not officially transferred in April of 2008, both LCPIC and ITBD have been honoring and working under the original contract. We agree that it would be better to have a new contract between LCPIC and ITBD and are in formal contract negotiations with ITBD at this time. However, the negotiations have been complicated because both parties understand we will be phasing out our use of ITBD with the implementation of our new policy management system in 2010. We have a very detailed and formalized contract with the vendor for our new policy management system (West Point Underwriting). We will have a signed contract with ITBD by January 1, 2010. Dan Laffey, our CIO, and Paige Harper, our Corporate Council, are managing the contract negotiations with ITBD.

Although the contract negotiations with ITBD have not been finalized, there have been no instances of ITBD making unauthorized changes to the LPMS system. All system changes go through user acceptance testing and approval before implementation.

Sincerely,

John Wortman

J. John Wortman
CEO
Louisiana Citizens Property Insurance Corporation

LOUISIANA CITIZENS
Property Insurance Corporation

433 Metairie Road, Suite 600
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November 9, 2009

Steve J. Theriot, CPA
Louisiana Legislative Auditor
1600 North Third Street
P.O. Box 94397
Baton Rouge, LA 70804-9397

Dear Mr. Theriot:

Please find our responses to the audit findings noted below:

Audit Finding: Inadequate Documentation of Information Systems

We agree that the documentation of our LPMS policy management system is inadequate. However, as the auditors know, we are in the process of replacing the LPMS policy management system. We do not believe it would be prudent to utilize our personnel or incur the financial cost to document a system that we are actively replacing. Our new policy management system (EPIC) will be fully documented.

We enlisted the State of Louisiana Purchasing Department to help us purchase our new policy management system. The requirement for the vendor to be SAS 70 compliant was not a part of the state process; however, we concur with the audit advice and will make this an important element of all future IT contracts.

The audit comment that the primary vendor for our LPMS system has refused to sign a contract is not true. We are currently, and were in active contractual negotiations with ITBD before the audit began. We do not understand why the auditor would state that he brought up the issue since we provided the auditor with a draft copy of the proposed contract. The efforts to formalize a contract with ITBD began in January 2009, well before the beginning of the audit.

We concur that we need to increase our written IT documentation, and are in the process of doing so. We are spending our efforts and resources to ensure our new system is documented. We are not expending resources to document a system that we are in the process of replacing. LPMS and ORBS will be phased out over the next 15 months.

We do have written documentation for Data Mart, but will update it to make sure it is current. Our review will be led by Dan Laffey and will be concluded by January 1, 2010.

Sincerely,

John Wortman

J. John Wortman
CEO
Louisiana Citizens Property Insurance Corporation

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November 9, 2009

Steve J. Theriot, CPA
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1600 North Third Street
P.O. Box 94397
Baton Rouge, LA 70804-9397

Dear Mr. Theriot:

Please find our responses to the audit findings noted below:

Audit Finding: Lack of Information Technology Policies and Procedures

LCPIC does in fact have IT policies and procedures. The issue noted is that we need to increase the formal written documentation of our policies and procedures. We are in the process of strengthening and documenting our IT policies and procedures. Dan Laffey, LCPIC CIO, is leading the effort and anticipates the project will be completed by the end of May 2010.

Sincerely,

John Wortman

J. John Wortman
CEO
Louisiana Citizens Property Insurance Corporation