



THE STATE OF FLORIDA

**OFFICE OF INSURANCE REGULATION
MARKET INVESTIGATIONS**

MARKET CONDUCT FINAL EXAMINATION REPORT

OF

**FLORIDA WORKERS' COMPENSATION JOINT
UNDERWRITING ASSOCIATION, INC.**

AS OF

December 20, 2012

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PURPOSE AND SCOPE OF EXAMINATION

The Florida Office of Insurance Regulation (Office), Market Investigations, conducted a target market conduct examination of Florida Workers' Compensation Joint Underwriting Association, Inc. (FWCJUA or the Company) pursuant to Section 624.3161,(5)(v), Florida Statutes. The examination was performed by Examination Resources, LLC. The scope period of this examination was January 1, 2009, through September 30, 2012. The onsite examination began December 10, 2012 and ended December 20, 2012.

The purpose of this market conduct examination was to determine FWCJUA's compliance with Florida Statutes, the Florida Administrative Code, its plan of operation, and its internal operational procedures. The operational review of current systems and controls included the evaluation of FWCJUA's processes for corporate records, general operations, accounting, information systems, complaint handling, servicing organizations, agent practices, rating and underwriting, premiums, general claims, investments, reinsurance, and legislative changes.

FWCJUA utilizes Travelers Indemnity Company (Travelers) to provide policy administration, managed care services, and claim administration. Under the terms of Travelers contract with the FWCJUA, after applicant's eligibility is verified by the FWCJUA, Travelers underwrites and issues policies, collects premiums, performs premium audits, and adjusts and pays claims. Information pertaining to the internal controls of the FWCJUA and its service provider was provided by the Certified Public Accounting firm of Thomas Howell Ferguson P.A. (CPAs), who performed detailed testing of the respective internal controls. This examination relied on the substantive testing of internal controls performed by Thomas Howell Ferguson P.A.

FWCJUA's records were examined at its home office, located at 6003 Honore Avenue, Suite 204, Sarasota, Florida. Documentation utilized in this report was provided by the Company, the independent auditors, and other external sources.

The Report is based upon information obtained during the examination, additional research conducted by the Office, and additional information provided by the Company. Procedures and conduct of the examination were in accordance with the *Market Conduct Examiner's Handbook* and the *Financial Condition Examiners Handbook* produced by the National Association of Insurance Commissioners.

OPERATIONS REVIEW

CORPORATE RECORDS

The FWCJUA was created on December 30, 1993, pursuant to Section 627.311(5), Florida Statutes, to provide workers' compensation and employers' liability insurance coverage to eligible Employers who are required to maintain workers' compensation and employer's liability insurance and who are in good faith entitled to, but unable to purchase such insurance through the voluntary insurance market. As a result, employers insured within the FWCJUA pay premiums in excess of those paid in the voluntary market. The FWCJUA collects premiums from its policyholders in order to satisfy the obligations of the FWCJUA. If the FWCJUA is unable to pay its obligations, certain policyholders will be required to contribute, on a pro-rata-earned-premium basis, the amounts necessary to meet any assessment levied to fund the deficit.

The FWCJUA is a not-for-profit corporation which accounts for its activities using a calendar year ending on December 31st, and is exempt by statute from State of Florida corporate income taxes, premium taxes, intangible taxes, and assessment from the Division of Workers' Compensation and the Florida Workers' Compensation Insurance Guaranty Association. The FWCJUA is exempt from federal income taxes in accordance with Section 501(c)(6) of the United States Internal Revenue Code.

The FWCJUA operates under the supervision of a nine member Board of Governors (Board) pursuant to a Plan of Operation. By statute, the Board is to be comprised of two representatives from the 20 domestic insurers defined in Section 624.06(1), Florida Statutes, two representatives from the 20 foreign insurers defined in Section 624.06(2), Florida Statutes, three members appointed by the Financial Services Commission, the consumer advocate appointed under Section 627.0613, Florida Statutes, and one representative from the state's largest property and casualty agents' association. All board members, except the consumer advocate, are appointed by and serve at the pleasure of the Financial Services Commission. Board members serve for four-year terms or until their successor is chosen.

The Board utilizes committees to monitor the operations of the FWCJUA. The committees of the Board include the following:

- Audit Committee
- Producer Appeals Committee
- Executive Compensation Committee
- Rates & Forms Committee
- Investment Committee
- Reinsurance Committee
- Operations Committee
- Safety Committee
- Market Assistance Plan (MAP) Committee
- Producer Committee

Board Committee members are appointed by the Board Chair and Board Committees meet periodically as the need arises.

The examination procedures included:

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

Recommendations

1. In reviewing the prior exam findings, the finding regarding the lack of documentation of the Succession Plan has not been remedied. Per discussion with the FWCJUA, succession planning is an informal process and the Board deemed formal documentation procedures not necessary. We again recommend that the FWCJUA document a formal succession plan.
2. In reviewing the prior exam findings, the finding that Travelers does not provide a SAS 70/SOC 1 report, has not been remediated. Travelers does not provide a SAS 70 or SOC 1 report; however, the FWCJUA has implemented internal audits of Travelers to monitor their activity. FWCJUA's CPAs also evaluate Travelers' reporting data. Examiners performed a review of both these assessments and, while appropriate monitoring appears to be in place, the recommendation to have Travelers complete a SAS 70/SOC 1 is continued.

GENERAL OPERATIONS

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

- Reviewing deficit assessments
- Reviewing the authorization and payment of general expenses.

The FWCJUA is authorized to assess certain policyholders, subject to the approval of the Office, amounts necessary to support operations. From the FWCJUA's inception through July 2003, there were three rating plans established for various classifications of risks and all employers holding FWCJUA policies were assigned to one of these three rating subplans, either A, B, or C, with subplan C insureds receiving an assessable policy.

Effective July 26, 2003, legislation was adopted that resulted in significant changes to the FWCJUA's rating structures. A new subplan D was established to provide coverage for small employers (15 or fewer employees) and charitable organizations. The rates prescribed for these policies were 25% above the voluntary market premiums for small employers and 10% above the voluntary market premiums for charitable organizations. Those capped rates generated a substantial deficit with the only means of elimination of the deficit being to levy an assessment on subplan D policyholders.

Effective, July 1, 2004, legislation was adopted that implemented a tier rating that replaced the subplan rating structure discussed in the previous paragraph. The tier rating plan provided for limitations on rates for Tiers 1 and 2 and assessments, if necessary, against all workers' compensation insureds in the state of Florida to fund its cash flow deficits, if any. Effective January 1, 2007, these limitations on rates for Tier Plans 1 and 2 were removed to allow for actuarially sound rates. Tier 3 is to charge actuarially sound rates with assessments against all Tier 3 insureds if rates are insufficient to fund its losses. Should funding for the tier rating plans be insufficient, an assessment could be levied against all workers' compensation insureds in the State of Florida to fund the FWCJUA's cash flow deficits, or funds from the State of Florida Workers' Compensation Administration Trust Fund (WCATF) may be transferred to the FWCJUA upon the request of the State of Florida Department of Financial Services (DFS) by the FWCJUA's Board of Governors (Board) with the approval of the Legislative Budget Commission (LBC).

During 2011, FWCJUA was required to file a funding request with the Office that demonstrated its cash requirements for funding the subplan D losses. These transfers are recognized in the period approved by the Legislative Budget Commission. The Association did not receive any transfers from the WCATF during 2011 or 2010. At December 31, 2011 and 2010, the Association has recorded a liability of \$4,241,000 and \$4,301,000, respectively, related to unused transfers received from the WCATF. This amount is included in accounts payable and accrued expenses on the statements of admitted assets, liabilities, and surplus.

No assessments were recommended in fiscal years 2009, 2010, 2011, or through September 30, 2012.

The FWCJUA's management team is comprised of one Executive Director, one Controller, three Managers, and one Supervisor. The FWCJUA's staff is organized into the following functional areas:

Executive Director	1
Accounting	2
Operations / Program Managers	1
Underwriting	4
Information Technology	2
Administrative	2
Total	<u>12</u>

Because of the extensive use of Travelers as its service provider, the FWCJUA is able to operate efficiently with the current employees. A review of FWCJUA's organizational and management structure was completed by reviewing the organizational chart and the background history of the FWCJUA, touring the office of the FWCJUA, observing FWCJUA personnel performing their duties, reviewing the job descriptions of each staff position, and discussing with management, the duties and responsibilities of the FWCJUA staff, the Board and Board Committees.

The staffing level of the FWCJUA appears to be adequate. FWCJUA staff and management are qualified to perform their duties, and the duties are adequately segregated. There were no noted conflicts of interest. FWCJUA's management and organizational structure is functional and enables the FWCJUA to execute its duties as provided by Section 627.311(5), Florida Statutes.

ACCOUNTING

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

- Verification that the Company's trial balance agreed to the filed Annual Statement at December 31, 2011
- Verification that the filed 2011 Annual Statement agreed to the audited financial statements
- Verification that the Company completed all filings as required by the Florida Office of Insurance Regulation (Office) and the State of Florida Department of Financial Services (DFS)
- Review of the processes and procedures for financial reporting

As required by the Office, the FWCJUA had an annual audit completed on its financial statements for the reporting periods ending December 31, 2011 and 2010. The audits

were performed by the accounting firm of Thomas Howell Ferguson P.A., who issued unqualified audit reports for 2011 and 2010.

Testing concluded all filings were completed timely and accurately. A review of the Company's financial reporting process and procedures, as well as a review of the work performed by Thomas Howell Ferguson P.A., did not identify any material weaknesses in controls over the financial reporting process.

INFORMATION SYSTEMS

An Information Systems examination was completed as part of the Office's Market Conduct Examination of the Company as of December 31, 2012.

Scope

- Obtain and review information systems structure and standards for development, configuration, utilization, integrity, security, and recovery plan.
- Review controls over system utilization, integrity, and security.
- Document walkthrough of security of computer room and physical security.
- Review disaster recovery plan and business recovery procedures.

Financially significant applications specific to the FWCJUA included the following:

- Tropics – The policy management, premium transaction processing and producer management system. The Company transmits a nightly update to Travelers exported from Tropics to report newly bound policies.
- FLARE4 – The claims record management system. The Company receives a monthly update from Travelers imported into FLARE4 to reflect up-to-date claims information.
- Great Plains Dynamics – The Accounting and General Ledger system.
- Clearwater Analytics – The Investment tracking/management system.

Observations & Recommendations

In reviewing and observing the processes by which the IT department functions, the examiners identified one IT general functional issue:

1. During the course of the examination, it was noted that the company did not have any formal policies over IT, information security, acceptable use, software development lifecycles and/or change management except for a Telecommuting Policy and a brief mention in the Code of Conduct. Additionally, policies that are formalized must be approved and dated by senior management.

Recommendation: The Company must have policies to define expectations and practices for (at a minimum) information security, acceptable use of systems and data, change/configuration management, and software development lifecycle. Policies should

clearly cover the services, systems and processes in practice at the Company for ensuring that policies, premiums and claims are accurately processed. Additionally, policies must be approved and dated by senior management.

Conclusion

Based on the scope of the examination, it appears that the FWCJUA operates with adequate internal controls over Information Technology through support of executive management and with the oversight of the Board of Governors. However, we recommended that all policies related to information security and controls be documented and approved by senior management.

COMPLAINTS REVIEW

The FWCJUA's complaints can originate from various sources including Florida Department of Financial Services (DFS) consumer complaints and from policyholders. Incoming complaints are recorded in the complaint log by an underwriter at FWCJUA or Travelers. The underwriter will work to resolve the issue and provide a response. A review of the complaint register provided by FWCJUA indicated the following:

- There were a total of 20 complaints for the entire exam period January 1, 2009 through September 30, 2012.
- All 20 items were resolved timely and are closed.
- The reasons for the complaints are follows:
 - 19 Payroll Audit/Additional Premium Disputes
 - One DFS consumer complaint

Review of the complaint handling procedures and the complaint logs indicates complaints are being appropriately tracked and managed.

SERVICING ORGANIZATIONS

The FWCJUA contracts with many service organizations to provide various services including auditing services, investment manager services, investment custodian, actuarial services, legal and public affairs services, reinsurance broker services, collection services, policy administration and managed care services, and other services.

The examiner inquired of the Request for Proposal (RFP) process and how contracts are accepted and monitored. The FWCJUA requires competitive solicitation for purchases greater than \$25,000 except in situations of specialized sole source expertise and those exempt from competitive bidding according to Section 287.057(3)(f), Florida Statutes. The FWCJUA's Operations Manual notes the Service Provider eligibility requirements, application process, and performance standards, and appears to be clear, comprehensive, and adequate for the purposes of the FWCJUA.

As part of the examination, the following areas of procurements were reviewed:

- Review of the request for proposals process and Operations Manual on service providers
- Review the service providers reporting requirements manual
- Review of the Board of Governors involvement in the process, including review of minutes to ensure contracts were approved by the Board
- Review of all contracts and agreements in effect during the exam period
- Review external and internal audits performed of the service provider, Travelers
- Review market conduct examination reports prepared by other states on the FWCJUA's service provider, Travelers.

Adequate policies and procedures are in place to accept and monitor service providers.

AGENCY/PRODUCER PRACTICES

FWCJUA administers the Florida Workers Compensation residual market and does not employ a system to actively seek business. No producer or agency may submit applications for coverage to the FWCJUA or directly or indirectly receive compensation in connection with business written by the FWCJUA unless the producer and his or her affiliated agency jointly enter into and maintain an Agency Producer Agreement with the FWCJUA. Agencies and their Designated Producers do not have binding authority and must follow strict guidelines for authorization. Prior to authorization, an agency and its designated producers must go through an eligibility review, meet specific requirements identified in the Operations Manual and on the FWCJUA website, and be in good standing with the DFS. The Board of Governors' Producer Committee oversees the Agency Producer program. Agencies are reviewed annually to verify errors and omissions insurance requirements and that the agency, its designated producer(s) and customer service representative(s) licenses are current.

The examination testing procedure included:

- Reviewing the policies and procedures for the utilization of agencies and producers, including the appointment and approval process
- Reviewing the flow of operations of the agency/producer authorization process for weaknesses in controls
- Reviewing agency/producer fee payment procedures
- Reviewing the Market Assistance Plan (MAP) and to ensure the agency force is enforcing placement of insurance with the FWCJUA as a last resort.

The FWCJUA has developed a Market Assistance Plan (MAP). The purpose of the MAP is to implement Sections 627.311(5)(c)4.d. and 627.311(5)(c)24, Florida Statutes, by providing access to and assisting in the placement of workers' compensation and employers' liability insurance coverage in the voluntary market for employers applying for or securing coverage through the FWCJUA. The MAP assists employers who submit applications for coverage to the FWCJUA in obtaining coverage in the voluntary market

and does not assist in the placement of any types of coverage other than workers' compensation and employers' liability insurance coverage.

The controls in place for the agent services processes were found to be adequate.

RATING AND UNDERWRITING AND REVIEW

As a residual market program, the FWCJUA's eligibility determination and application process is a complete underwriting process involving verification of exposures, classification determination, premium calculation, and constant communication with the producer, employer, carriers, regulators and state agencies.

During the annual audit of the FWCJUA performed by the Company's CPAs, a substantive review of a random sample of records was performed.

The examination testing procedure included:

- Reviewing FWCJUA's underwriting principles and procedures guide, practices and rates utilized during the scope period
- Reviewing FWCJUA's Plan of Operation during the scope period
- Reviewing external auditors' testing of underwriting and rating
- Reviewing the actuarial report for adequacy of rates.

Based upon the examiners review of the FWCJUA's policies and procedures of underwriting and rating, the documented procedures and controls in place are adequate for the operations of the FWCJUA.

PREMIUMS

The FWCJUA utilizes the Travelers to provide policy administration services, including the cancelation of policies and collection of premiums. Travelers follows the FWCJUA's minimum performance standards and its own internal procedures for policy administration, policy cancellation, and premium collection procedures for FWCJUA business.

During the annual audit of the FWCJUA performed by the Company's CPAs, a substantive review of a random sample of records is performed.

The examination testing procedure included:

- Reviewing FWCJUA's underwriting principles and procedures guide, practices and rates utilized during the scope period
- Reviewing FWCJUA's policy cancellation procedures
- Reviewing FWCJUA's premiums collections, reporting, and flow of operations
- Reviewing external auditors' testing of premiums

- Reviewing Market Conduct Examination Reports prepared by other states on the FWCJUA's service provider, Travelers.

Based upon the examiners review of the FWCJUA's policies and procedures of policy administration and premium collections, the documented procedures and controls in place are adequate for the operations of the FWCJUA.

GENERAL CLAIMS REVIEW

Below is a table showing the FWCJUA's claim activity for the exam period as of December 31st for each respective year end:

Description	2009	2010	2011
Number of Policies Issued	1039	890	970
Number of Claims	108	87	100
Number of Open Claims	20	31	55
Paid Losses	\$393,444	\$655,459	\$1,913,965

Below is a table showing the claims development for the exam period at December 31, 2011 and September 30, 2012. The figures are the total amounts at each referenced date as of date for the referenced loss year:

Description	2009	2010	2011
As of December 31, 2011:			
Number of Claims Reported	116	95	100
Number of Open Claims	1	11	55
Paid Losses	\$687,690	\$1,340,657	\$1,913,965
As of September 30, 2012:			
Number of Claims Reported	116	96	112
Number of Open Claims	0	8	24
Paid Losses	\$689,416	\$1,480,497	\$2,670,203

The FWCJUA utilizes Travelers to provide claims administration services, including the settlement of claims. Travelers follows the FWCJUA's minimum performance standards and its own internal claims handling procedures for FWCJUA business. The FWCJUA is responsible for monitoring claims and settlement proposals, reviewing and monitoring the Serious Injury Activity Report prepared by Travelers, discussing claims with the adjuster or litigation manager when necessary, and reporting claims to the reinsurance provider. The FWCJUA has a documented Claims Handling Procedures for FWCJUA staff.

During the annual audit of the FWCJUA performed by the Company's CPAs, a substantive review of a random sample of records was performed.

The examination testing procedures included:

- Reviewing FWCJUA's and Travelers' claim handling procedures
- Reviewing the external auditors' walkthrough and testing of the claim process, including testing performed on-site at Travelers
- Obtaining a list of the population of all claims reported during the scope period
- Reviewing claim reporting and statistics procedures
- Reviewing the procedures for use of counsel representation
- Reviewing Market Conduct Examination Reports prepared by other states on the FWCJUA's service provider, Travelers.

The FWCJUA has demonstrated adequate controls over their claims processes, which were adequately tested by the external auditor.

INVESTMENTS

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

- Reviewing FWCJUA's investment guidelines
- Comparing its investment guidelines to its plan of operation
- Review of the process and procedures for investments
- Reviewing the CPA's work papers relative to cash and investments
- Verify the accuracy of investments reported.

FWCJUA investments are to be made in accordance with the Prudent Investor Rule and the Insurer Investment Diversification requirements set forth in Sections 518.11 and 625.305, Florida Statutes, respectively, and adhere to the FWCJUA's enabling statute Section 627.311(5), Florida Statutes.

The Investment Policy documents the procedures for the investment of the FWCJUA's assets. The Investment Committee is responsible for overseeing the investment process and making recommendations to the Board. The FWCJUA utilizes the services of an Investment Custodian, US Bank.

On June 13, 2012, an investment management agreement was signed with Prime Advisors to provide objective, third-party advice and counsel to enable the FWCJUA to make informed decisions regarding the investment of the FWCJUA's assets.

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

- Cash – Cash management, bank reconciliations, accounts payable, cash and cash disbursements, and payment services.
- Investments – Investment accounting, account reconciliation, investment policies and procedures, and financial reporting.
- Management Reporting – Policies and procedures for the monthly reporting to the Board of Governors, review of Investment Committee minutes, and review of investment reports provided quarterly to the Board.

The FWCJUA has adequate documentation of controls for the cash and investments processes. There were no gaps or weaknesses in controls identified by the external auditor and the controls tested by the external auditor were noted as working effectively.

The external auditors perform detail testing on cash and investments. As part of the examination the total of cash and investments was agreed to the trial balance. No exceptions were noted by either the auditor or the examiner.

FWCJUA has demonstrated adequate controls over their investment processes. The investment balances have been adequately tested by the external auditor.

REINSURANCE

The FWCJUA maintains a reinsurance program with several reinsurance companies through a reinsurance intermediary, AON Benfield. The FWCJUA is responsible for keeping the reinsurer informed of any claims that potentially will become a liability for the reinsurer, and advising the reinsurer of any claims activity, including recoveries.

The examination included:

- Review of the reinsurance program, processes and procedures
- Review of the reinsurance contracts
- Review of the reinsurance authorizations, including the review of the Reinsurance Committee minutes
- Review of external auditors testing of the reinsurance program

The Reinsurance Committee is responsible for overseeing the reinsurance program. The Company's process for purchasing reinsurance has a high level of management oversight and Board involvement in the decision making process.

Recommendations

1. The reinsurance contracts do not contain an Entire Agreements Clause. The NAIC Accounting Practices and Procedures (APP&P) Manual, SSAP No. 62R states that the reinsurance agreement shall constitute the entire contract between the parties. This is listed as a required term for reinsurance agreements in SSAP No. 62R. The AP&P Manual is a required reference by all states and, therefore,

we recommended that the Entire Agreements Clause be included in the reinsurance contracts.

LEGISLATIVE CHANGES

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

As part of the examination, a review was conducted of the processes and controls FWCJUA has in place to monitor and communicate the legislative changes affecting the Company's operations.

During the examination scope, there has been only one pertinent change that affected the FWCJUA:

- During 2012 – The Florida Legislature passed HB 7105. The bill re-enacted the public records and public meetings exemptions created in HB7169 in 2007.

The examiner identified in the Board minutes that FWCJUA demonstrated adequate processes and controls to monitor and communicate the legislative changes to the Board and Management.

EXAMINATION FINAL REPORT SUBMISSION

The Office hereby issues this report as the Final Report, which is based upon information from the examiner's draft report, additional research conducted by the Office, and additional information provided by the Company.