

FINANCIAL SERVICES COMMISSION

**FLORIDA OFFICE OF INSURANCE REGULATION
MARKET INVESTIGATIONS**

TARGET MARKET CONDUCT FINAL EXAMINATION REPORT

OF

FRANK WINSTON CRUM INSURANCE, INC.

AS OF

January 14, 2005

NAIC COMPANY CODE: 11600

EXAMINER:

**EXAMINATION RESOURCES, LLC
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PURPOSE AND SCOPE OF EXAMINATION

Under authorization of the Financial Services Commission, Florida Office of Insurance Regulation (Office), Market Investigations, pursuant to Section 624.3161, Florida Statutes, a target market conduct examination of Frank Winston Crum Insurance, Inc. (Company) was performed by Examination Resources, LLC. The scope of this examination was April 30, 2003 through January 14, 2005. The examination began December 13, 2004 and ended January 14, 2005.

The purpose of this examination was to review the Company's practices in handling workers' compensation business from Professional Employer Organizations (PEO), review of premiums and classifications, review of complaints and cancellations related to PEO business, and to verify compliance with Florida Statutes and the Florida Administrative Code. The Company records were examined at its home office located at 100 S. Missouri Ave, Clearwater, Florida.

This Final Report is based upon information from the examiner's draft report, additional research conducted by the Office, and additional information provided by the Company. The files examined were selected systematically from data files provided by the Company using Microsoft Excel's "random sample" selection process. Procedures and conduct of the examination were in accordance with the Market Conduct Examiner's Handbook produced by the National Association of Insurance Commissioners.

Error tolerance levels applied are as follows: monetary returns under \$5.00 were waived; zero tolerance levels were applied to all improprieties by the Company which were in violation of Florida Statutes and Rules.

POLICY AND CERTIFICATE REVIEW

Frank Winston Crum Insurance, Inc. is a domestic property and casualty insurer licensed to conduct business in the State of Florida. The Company provides workers' compensation insurance to Crum Services, a Professional Employer Organization. A PEO, also referred to as an employee leasing company or staff leasing company, provides human resources and administrative services to businesses that elect to outsource functions, such as human resources support, benefits administration, payroll, and federal and state employment tax filings. Additionally, a PEO provides workers' compensation coverage for all leased employees. There is common ownership between the Company and the PEO.

The Company uses rates filed by the National Council on Compensation Insurance, Inc. (NCCI) and filed with the Office a large deductible rating plan that was used for the business written during the scope of this examination.

Total written premiums during the scope of the examination are broken down as follows:

| Year | Total Written Premium |
|-------|-----------------------|
| 2003 | \$ 8,102,403 |
| 2004* | \$11,323,836 |

* Earned Premium as of 9/30/04

The Company issues policies, and certificates of insurance are issued by the PEO. The Company does not have any process in place to verify the use of certificates of insurance issued by the PEO.

Corrective Action: The Company should establish procedures for periodic review of certificates of insurance issued by the PEO to verify accuracy and appropriate use of certificates of insurance.

Proof of coverage is forwarded by the PEO to the Division of Workers' Compensation. The Company does not have any process in place to verify accuracy or timeliness of submissions. See "Findings" under this section.

The Company is only licensed in the State of Florida and there was no evidence of coverage provided in other states in the policies reviewed.

The Company determined premiums by estimating the expected payroll for the policy period and setting an average rate per \$100 of workers' compensation payroll as agreed with Crum Services, net of deductible credits and charges, to arrive at the estimated policy premium. At the end of the policy period, a final audited premium is derived by multiplying the workers' compensation premium by the rate per \$100 of payroll initially agreed. The final amounts are entered into the rating algorithm filed with the Office to ensure that the final premium is within the filed parameters. This methodology is not consistent with the filed rating plan. The filed rating algorithm should be used to determine the initial estimated premium and then again to develop the final premium. See "Findings" under this section.

Premium payment schedules and deductible recoupment are set on a monthly basis and policies reviewed showed that payments by the PEO were made timely. Payroll and classification codes were not submitted to the Company periodically. The 2003 policy term showed two (2) submissions and for the 2004 policy term, submissions were made on a quarterly basis. See "Findings" under this section.

The experience modification factors were not properly applied in the files reviewed. See "Findings" under this section.

Financial guarantees are not required for the large deductible policies. The Company stated that it receives payments monthly in advance, therefore, it does not require a financial guarantee to secure deductible recoupment. See "Findings" under this section.

Claims are handled by Broadspire Services, Inc. (Broadspire), formerly known as RSKCo Claims Services, Inc. located in Tampa, Florida. Loss results are monitored by the Company on a monthly basis. Claim frequency reviews are performed by the Company on a monthly basis. The Company has not performed audits of the claims services provided by Broadspire.

Corrective Action: The Company should establish procedures for periodic audit of Broadspire. The Company stated that it had planned to do an audit during 2004, however, it was postponed due to Broadspire's recent change in ownership. The Company determined that it was of greater value to evaluate the operational efficiency sometime in 2005. In addition, the Company stated that one of the Company's reinsurers performed a claim review of Broadspire in 2004 with acceptable results. A second reinsurer has scheduled another claims audit in January 2005.

Classification reviews are conducted by Colonial Risk Management, Inc. (Colonial), which provides safety and risk management consulting services on behalf of Crum Services. While performing inspections, class codes are verified. However, current procedures only require inspections of client employers that have six (6) or more employees. Classification reviews are not conducted at the final audit. See "Findings" under this section.

The Company advised that the PEO has safety professionals that work directly with client employers. However, the Company does not routinely audit the PEO's operations for verification that the PEO has a properly implemented program. See "Findings" under this section.

Unit Statistical reporting services are provided by Midwest Insurance Services, Inc. (Midwest) located in Orlando, Florida. As a result of this examination, the Company has expanded the functions of Midwest to include the following:

- Policy Issuance and Regulatory Compliance - Includes policy rating, preparation and issuance, file maintenance and record keeping. Record for NCCI addition and termination accounts throughout policy year.
- Regulatory Compliance Services – Consulting services as needed.
- Midwest Database Management - Management database that enables the Company, Broadspire and Midwest to have the same information to work with. This includes policy information and claims information together for management reports that will continue to evolve over time. Information will include payroll, client numbers, client locations, all claims data and information on terminated clients (export function for NCCI form FL 1372).

Findings

The Company wrote two (2) policies, new and first renewal, issued to Crum Services during the scope of the examination. These policies provided coverage to 2,799 client employers.

Both policies were reviewed. One hundred (100) client employers with 257 class codes were also reviewed.

Eighty (80) errors were found, involving both policies. Three (3) errors resulted in undercharges totaling \$4,306,848.

The errors are broken down as follows:

1. One (1) error was due to failure to obtain a notarized signature of the insured on the application. This constitutes a violation of Rule 69O-189.003(2)(b), Florida Administrative Code.

Corrective Action: The Company should obtain a signed and notarized application. The Company has secured a signed and notarized application.

- Two (2) errors were due to failure to follow the filed rate. This constitutes a violation of Section 627.191, Florida Statutes. The Company failed to apply the experience modification factor to the manual premium as required by the filed rating algorithm. These errors resulted in two (2) undercharges totaling \$3,716,544.

Corrective Action: The Company should correct this error for the 2004 policy term audit and the 2005 renewal should also include the experience modification factor in the filed algorithm. It was estimated that the 2004 policy term would generate a \$2,600,160 undercharge, which the Company should bill the PEO to collect the monies. The Company stated that it would correct this error at the next audit.

- One (1) error was due to failure to follow the filed rate. This constitutes a violation of Section 627.191, Florida Statutes. This error was due to the application of a .40 factor for the expected loss ratio while developing the deductible premium. The filed plan states that the allowable range is from .50 to .90. This error resulted in an undercharge totaling \$590,304. This error was only applicable to the 2003 policy term.

Corrective Action: The Company should follow its filed plan. The Company stated that it would follow its filed plan starting with the 2004 policy term audit. The Company should bill the PEO to collect the undercharged premium of \$590,304.

- Two (2) errors were due to failure to follow the filed rate. This constitutes a violation of Section 627.191, Florida Statutes. These errors were due to failure to document deviations of filed factors. The filed plan allows for deviation within specific ranges, however, deviations should be documented and supported in the policy file.

Corrective Action: The Company should establish procedures for documenting deviations from the filed factors. The Company stated that it would establish procedures to comply with this requirement.

- Two (2) errors were due to failure to follow NCCI manual rules. This constitutes a violation of Section 627.191, Florida Statutes. The following was missing from the policy information page: Company NAIC code, insurer address and kind of insurer, risk identification number and experience modification factor.

Corrective Action: The Company should establish procedures to ensure this information is included on the information page of the policy. The Company stated that it has contracted with Midwest Insurance Services to issue policies starting with the 2005 term and they will include the required information.

- One (1) error was due to failure to conduct routine audits of PEO safety programs. This constitutes a violation of Section 627.0915, Florida Statutes. The Company relies on the PEO to conduct loss control services, however, the Company does not routinely audit the PEO's operations for verification that the PEO has a properly implemented program.

Corrective Action: To assure acceptability of the PEO's risk management services, the Company should monitor and conduct routine audits of the PEO's operations and make recommendations and issue directives, as appropriate, to assure a properly implemented program and to ensure that employers are eligible for premium discounts. The Company

stated that it would begin auditing the PEO's operation. In addition, the Company would develop a program to monitor the classification review process, loss control services, and onsite inspections.

7. One (1) error was due to failure to complete an audit properly. This constitutes a violation of Section 627.192(9), Florida Statutes. The Company relied solely on the PEO's payroll submissions to complete the audit.

Corrective Action: The Company should ensure that all sources of payment by the PEO to employees have been reviewed and the accuracy of classifications of employees have been verified. Payroll and classification verification audit rules must include, but not be limited to, state and federal reports, payroll and other accounting records, certificates of insurance and duties of employees. The Company stated that starting with the 2004 policy year premium audit, the Company will conduct a more thorough review of state and federal reports, certificates of insurance, and duties of employees.

Based upon the findings noted here, as well as other issues found in the report, the Company has failed to establish procedures to monitor the PEO's performance to ensure that they are meeting the requirements of the contract between the insurer and the PEO. It is recommended that a follow up examination be conducted to determine whether or not the PEO is meeting the obligations of the contract.

8. One (1) error was due to failure to obtain payroll and class codes submissions periodically. This constitutes a violation of Section 627.192(3)(b), Florida Statutes. For the 2003 policy term, two (2) submissions were made and for the 2004 policy term it was received on a quarterly basis.

Corrective Action: The Company should obtain payroll and class codes submissions on a monthly basis. The Company disagreed with this request. The Company stated that during the 2004 policy year, the Company requested (and received) quarterly payroll and class code submissions from the PEO in order to determine whether the 2004 policy estimates were within a reasonable range. The Company had determined during the 2004 policy year that the submissions were within a reasonable range of the estimate used at policy issuance. The Company believes at this time that monthly payroll and class code submissions would create an undue burden on the PEO given that estimates to date have accurately reflected the position of the PEO's payrolls. If, in future policy years, the Company receives a quarterly submission that either exceeds or is below a reasonable amount estimated for the period submitted, the Company will require monthly submissions. Additionally, the President of the Company has bi-weekly meetings with the PEO management which includes discussions on business coming into the Company.

9. Thirty-four (34) errors were due to failure to conduct on-site inspections. This constitutes a violation of Section 627.191, Florida Statutes. Company guidelines state that risks with six (6) or more employees are to be inspected. The PEO conducts this function.

Corrective Action: The Company should establish procedures for periodic review for compliance of functions performed by the PEO on the Company's behalf.

10. Twenty-seven (27) errors were due to failure to maintain complete records of client employer data. This constitutes a violation of Section 627.192, Florida Statutes. Company guidelines state that a complete client data survey with a detailed description of operations will be obtained. Client data forms were incomplete or missing. The forms are maintained by the PEO.

Corrective Action: The Company should establish procedures for periodic review for compliance of functions performed by the PEO on the Company's behalf.

11. One (1) error was due to the use of an incorrect class code. This constitutes a violation of Section 627.191, Florida Statutes. Class codes could not be verified for all files due to the missing or incomplete data mentioned above. The Company does not have a mechanism in place for review of class codes. These are only reviewed when an inspection is done.

Corrective Action: The Company should establish procedures for periodic review for compliance of functions performed by the PEO on the Company's behalf.

12. Seven (7) errors were due to failure to obtain evidence that client employers did not owe premium to their prior carrier or prior PEO. This constitutes a violation of Section 627.192(8), Florida Statutes. Current procedures by the PEO are to obtain a signed affidavit from the client employer certifying that it did not owe any premiums, however, the review showed inconsistency in the process.

Corrective Action: The Company should establish procedures for periodic review for compliance of functions performed by the PEO on the Company's behalf.

In view of the many functions the PEO performs on the Company's behalf, the Company should formally establish a written contract or agreement with the PEO, which will define all the functions that the PEO performs on the Company's behalf and should also include the Company's right to periodically review for compliance and make recommendations. Such agreement should establish the frequency the Company would conduct reviews. The Company responded that it would memorialize its agreements with the PEO in a formal contract that will include and define all functions performed by the PEO on behalf of the Company. In addition, the Company stated that it would establish procedures for periodic review of all functions performed by the PEO on behalf of the Company. The Company should conduct an audit of the PEO to review safety inspections, payroll and classifications, produce a written report of findings and provide a copy of the report to the Office within sixty (60) days of the receipt of this report. The Company should also audit Broadshire for claims processing, produce a written report of findings and provide a copy to the Office within (60) days of receipt of this report.

COMPLAINTS REVIEW

The examination encompassed a review of complaints received by the Company that were related to PEO business. The Company received one (1) complaint during the scope of the examination.

Sample Findings

A complete record of all complaints received by the Company has been maintained as required by Section 626.9541(1)(j), Florida Statutes. Procedures for handling these complaints have been established by the Company.

One (1) complaint was reviewed.

No errors were found.

CANCELLATION/NONRENEWAL REVIEW

There were no policies cancelled during the scope of the examination. However, there were 509 client employers terminated. Certificates of insurance were reviewed to determine if proper notice of termination was provided and to determine if certificateholders were notified of terminations within thirty (30) days, as stated on the certificates of insurance. In addition, termination notices sent to the Division of Workers' Compensation were also reviewed.

Sample Findings

Fifty (50) client employer terminations were reviewed. Forty-nine (49) errors were found, involving thirty-two (32) client employers.

The errors are broken down as follows:

1. Five (5) errors were due to failure to notify certificateholders of coverage termination within 30 days. This constitutes a violation of Section 440.42(3), Florida Statutes. The Company relies on the PEO to provide notices to third party certificate holders where the PEO's practice is to send by fax. In addition, the date it was sent was not documented. The certificate of insurance states that notice shall be mailed. The Company does not have procedures in place to monitor compliance with timely notices.
2. Thirty-two (32) errors were due to failure of the PEO to timely notify the insurer of client employer terminations. This constitutes a violation of Section 627.192(6), Florida Statutes. This statute requires the PEO to issue termination notices directly to the client employer within a certain timeframe. The timeframes were not being met. The Company does not have procedures in place to monitor compliance with timely notices.
3. Ten (10) errors were due to failure to notify the Division of Workers' Compensation of client employer terminations. This constitutes a violation of Section 440.42(3), Florida Statutes. The Company relies on the PEO to send notices. The Company does not have procedures in place to monitor compliance with timely notices.
4. Two (2) errors were due to the use of an incorrect termination date on the termination notice sent to the Division of Workers' Compensation. This constitutes a violation of Section 440.42(3), Florida Statutes. The Company does not have procedures in place to monitor compliance with accurate notices.

Corrective Action: The Company should establish procedures to perform periodic audits of terminations to assure compliance with all four (4) issues. The Company responded by stating that it will establish procedures for periodic review of functions performed by the PEO on behalf of the Company.

REPORT SUMMARIZATION

A sample review of one hundred fifty-three (153) policy, complaint, and cancellation files was conducted for this Company. One hundred twenty-nine (129) errors were found. The following represents general findings, however, specific details are found in each section of the report.

Sample Files Reviewed -- 153

- Two (2) workers' compensation policies
- One hundred (100) certificates of insurance
- Fifty (50) cancellations
- One (1) complaint file

Findings

- Policy and Certificates – seventy-nine (79) errors – pages 3 to 6 of the report
 - Failure to apply experience modification factor, failure to apply expected loss ratio within filed range, and failure to document deviations of filed factors.
 - Failure to obtain a notarized signature of the insured on the application.
 - Failure to complete audit properly.
 - Failure to conduct periodic audits of PEO safety programs.
 - Failure to obtain periodic payroll and class code submissions.
 - Failure to follow filed NCCI manual rule by not displaying complete data in the information page of the policy.
 - Failure to conduct on-site inspections.
 - Use of incorrect class codes.
 - Failure to maintain complete records of client employers.
 - Failure to obtain evidence that client employer did not owe premiums to prior carrier or prior PEO.
- Cancellations – forty-nine (49) errors – page 7 of the report
 - Failure to notify certificateholder of coverage termination within 30 days.
 - Failure of the PEO to timely notify the insurer of client employer terminations.
 - Failure to notify the Division of Workers' Compensation of client employer terminations.
 - Use of incorrect termination date on the termination notice to the Division of Workers' Compensation.

Corrective Action:

The Company should provide a letter, signed by an officer of the Company, certifying that all corrective actions have been completed. The letter should be forwarded to the Office no later than thirty (30) days following receipt of the examination report.

EXAMINATION 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.