

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

STATE OF ALASKA
DEPARTMENT OF COMMERCE, COMMUNITY AND ECONOMIC DEVELOPMENT
DIVISION OF INSURANCE
PO BOX 110805
JUNEAU, AK 99811-0805

Order # TA 14-02)
In the Matter of Audit of)
Parker, Smith & Feek Inc.)
_____)

FINDINGS OF FACT

1. An audit report of Parker, Smith & Feek Inc., licensed in the State of Alaska, has been issued by the State of Alaska, Division of Insurance to Parker, Smith & Feek Inc.
2. The audit report of Parker, Smith & Feek Inc. (TA 14-02) has been transmitted to Jana Smith, Compliance Officer, Parker, Smith & Feek Inc. (Auditee), and Auditee has been accorded at least 30 days' opportunity to review and comment on this audit report.
3. The director of the Division of Insurance has fully considered and reviewed the report and any relevant portions of the auditor's work papers to the extent she considered necessary.

CONCLUSIONS OF LAW

1. The written audit report referred to in Finding of Fact No. 1 was issued in accordance with Alaska Statute (AS) 21.06.150(b).
2. The actions set forth in finding of Fact No. 2 were conducted in accordance with AS 21.06.150(b).
3. The director of the Division of Insurance has reviewed the audit report and any other relevant work papers as set forth in Finding of Fact No. 3 to the extent she considered necessary in accordance with AS 21.06.150(b).

ORDER

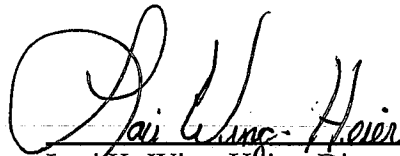
IT IS ORDERED

1. Pursuant to AS 21.06.150(b)(1), the audit report of Parker, Smith & Feek Inc. (TA 14-02) is approved as filed.

2. Pursuant to AS 21.06.060, the audit report shall be kept in the office of the director of the Division of Insurance and be open to public inspection.

This order is effective January 12th, 2015.

Dated this 12th day of January, 2015 at Juneau, Alaska.



Lori K. Wing-Heier, Director
State of Alaska
Division of Insurance

PREMIUM TAX AUDIT OF

Parker Smith & Feek Inc.

Alaska License #7868

TA 14-02

As of December 31, 2013

**Issued by
DIVISION OF INSURANCE
DEPARTMENT OF COMMERCE, COMMUNITY AND ECONOMIC
DEVELOPMENT
STATE OF ALASKA**



**FINAL REPORT:
January 12, 2015**

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THE STATE
of **ALASKA**
GOVERNOR BILL WALKER

**Department of Commerce, Community,
and Economic Development**

DIVISION OF INSURANCE

P.O. Box 110805
Juneau, Alaska 99811-0805
Main: 907.465.2515
Fax: 907.465.3422

January 12, 2015

Lori K Wing-Heier, CIC, CRM
Director, Division of Insurance
Department of Commerce, Community and Economic Development
550 West 7th Avenue, Suite 1560
Anchorage, AK 99501-3567

Pursuant to Alaska Statute (AS) 21.06.130, the Alaska Division of Insurance performed a limited and targeted premium tax audit of Parker Smith & Feek Inc. (the broker). The audit was conducted by Rebecca Nesheim, tax auditor for the Alaska Division of Insurance.

Parker Smith & Feek Inc.

SCOPE OF AUDIT

This premium tax audit was called to review compliance with the surplus lines statutes AS 21.34, and regulations 3 AAC 25 and the premium tax regulations 3 AAC 21.550 – 570. This is the third premium tax audit of Parker Smith & Feek Inc. conducted by the Alaska Division of Insurance. The second premium tax audit was completed on March 21, 2011.

Subject Matters Audited

The broker is an Alaska licensed surplus lines broker based in Anchorage, AK and Bellevue, WA. The Division elected to audit their quarterly filings and premium taxes and filing fees paid for accuracy and timeliness as well as required diligent search efforts, disclosures and notifications to the insured.

Time Frame

The audit covered this broker's surplus lines business for the years January 1, 2012 through December 31, 2013.

METHODOLOGY

The tax auditor sent the call letter and initial data requests to the broker's Anchorage, AK office. A list of all Alaska business transactions with nonadmitted insurers was requested for the period to be audited. The broker complied on a timely basis with all data requests. The number of policies written during the audit period was 66, from which a sample of 50 files was selected for audit.

The following are the procedure steps for the audit:

- 1) Verify that quarterly reports and accompanying forms were filed on time.
 - i) Audit steps taken:
 - (1) Reviewed the quarterly reports sent to the Alaska Division of Insurance and verified they were filed by the due date.
- 2) Verify the accuracy of the premium calculation
 - i) Audit steps taken:
 - (1) Reviewed policy, binders, and invoices to determine how taxable premium was calculated.
 - (2) Verified the correct premium was reported on the reports as filed.
- 3) Verify the accuracy of quarterly reports filed.
 - i) Audit steps taken:
 - (1) Reviewed the policy, binder, and endorsement pages in each file.
 - (2) If the effective date did not match the quarterly filing, reviewed the correspondence to ensure the documentation in the file matched when the policy was booked. Most of these occurred with endorsements that often require additional information and sometimes company approval before it can be added to the policy. The invoice date determines in which quarter the endorsement is required to be filed.
 - (3) Verified the quarterly reports as filed with the division were accurately filled out to reflect the correct effective date, premiums, taxes and fees based upon the information in the files.
 - (4) Verified a statement of exempt premiums was filed when appropriate.
 - (5) Verified the policy was included in the quarterly filing based upon the effective date of the policy.
 - (6) Verified the locations of risk were identified on the reports
- 4) If the placement is a multi-state placement, confirm Alaska is the home state of the insured.
 - i) Audit steps taken:
 - (1) Verified where the principal place of business or residence of the insured is located.
 - (2) Verified at least partial risk is located in Alaska
- 5) Verify if tax and filing fee payments were made on time and by ACH
 - i) Audit steps taken:
 - (1) Confirmed when the payments were received by the Alaska Division of Insurance and the payment method
- 6) Verify tax and filing fee payments were made accurately
 - i) Audit steps taken:
 - (1) Confirmed if the tax and fee payments matched the quarterly reports as filed.
- 7) Review effort made to place insured with an admitted insurer

- i) Audit steps taken:
 - (1) Verified the diligent search was documented prior to binding and the declinations completed. If no declinations due to risk on the placement list, the list effective at the time of placement was reviewed to ensure the risk was on the list
- 8) Review disclosures for use of non-admitted insurer
 - i) Audit steps taken:
 - (1) Reviewed the evidence of insurance to ensure the broker's name and stamp required by statute AS 21.34.100(e) is present and legible.
- 9) Review notifications for use of non-admitted insurer
 - i) Audit steps taken:
 - (1) Reviewed the correspondence and other documentation in the files to find a copy of the notification sent to the insured that meets the requirement in AS 21.34.110
- 10) Confirm coverage is placed with an eligible non-admitted insurer
 - i) Audit steps taken:
 - (1) Reviewed the Alaska published white lists and NAIC Quarterly Listings of Alien Insurers to ensure the company was eligible at the time of placement.
- 11) Review notice regarding nonrenewal and premium increase
 - i) Audit steps taken:
 - (1) Verified there was an Alaska Policyholder Notice regarding nonrenewal and premium increase included with the policy in the format approved by the Director of the Alaska Division of Insurance.
- 12) Other issues not previously identified as a procedure step were included when not in compliance with Alaska laws.
 - i) Audit steps taken:
 - (1) Reviewed documents to ensure other surplus lines statutes and regulations requirements were met.

Acceptable Error Rate:

The Broker's acceptable error rate for the above referenced standards and tests must be less than 10%.

PREMIUM TAX AUDIT

- | |
|---|
| 1. Verify that quarterly reports and accompanying forms were filed on time
<b style="text-align: right;">AS 21.34.080 and .170, 3 AAC 25.090 and .100 |
|---|

Comments: The eight quarterly reports with accompanying forms were filed on time.

Results: Passed (error rate 0%)

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|--|
| 2. Verify the accuracy of the premium calculation
<b style="text-align: right;">AS 21.34.180 |
|--|

Comments: The premium was calculated incorrectly for three policies in the audit files. Company policy fees were not included in premium. The total policy fees for the three policies were \$290. The tax and filing fees on this additional premium is negligible and will not be requested.

These errors affect two additional audit tests:

1. Accuracy of the Quarterly Reports
2. Accuracy of Tax and Fee Payments

Results: Passed (47 files passed & 3 failed, error rate 6%)

Recommendations: It is recommended the broker revise their written procedures to ensure all company fees are included in the calculation of premium tax and filing fees. The broker should read bulletin B 04-14 to reinforce their understanding of what fees are to be included in premium and what are not.

Broker's response: The Commercial Alaska State Surplus Lines Workflow will be updated to both stress the application of surplus lines taxes and fees on company fees, and to reference Bulletin 04-14.

- | |
|--|
| 3. Verify the accuracy of all quarterly reports filed
<b style="text-align: right;">AS 21.34.080 and .170, 3 AAC 25.090 and .100 |
|--|

Comments: The first quarter 2014 report should have included a transaction for an endorsement that was invoiced January 2014. The coding was incorrect for taxes and fees and an amended invoice was not completed until September 2014. The broker needs to file an amended first quarter 2014 report with this transaction.

This error affects one additional audit test: Accuracy of Tax and Fee Payments

Reporting errors occurred on 10 Report of Surplus Lines Transaction forms. The Division will not require the broker to go back and fix each of the errors but will expect future reports to be accurate. Here are the errors identified:

- a. Missing policy #'s or incorrect policy #'s

- b. Company name not accurate
- c. Effective date incorrectly identified
- d. Endorsement invoice dates incorrect (effective date of endorsement used)

Total accuracy errors: 11 within 10 distinct files

After July 21, 2011, there was some confusion about whether the location of risk when the policy had multi-state risk was still required to be reported since if the insured's home state was Alaska, then 100% of the policy was to be reported in Alaska. Locations of risk are still required to be reported per statute AS 21.34.080(a)(3) and the other states were not identified on the report as filed to the Division for three files. This will not be a finding in this audit but all future reports need to have locations of risk accurately identified.

Results: Failed (40 files passed & 10 failed, error rate 20%)

Recommendations: It is recommended the broker follow their written procedures for when endorsements are to be reported to the Alaska Division of Insurance. It is also recommended the broker review the specific information required to be on the Report of Surplus Lines Transaction form in statute and regulations and ensure these are followed for all reports sent to the Division.

Broker's response: Since the period under audit, PSF has increased our internal review process for written procedures. This has already resulted in a more comprehensive understanding of the guidelines, and improved accuracy on the Transaction forms. You are correct about the confusion over listing the locations of the risk on the Transaction forms - many employees interpreted that the determination of the home state as Alaska eliminated the need to list multistate locations. PSF will revise the Commercial Alaska State Surplus Lines Workflow to clarify this issue.

4. Verify the home state for insured is Alaska on multi-state placements
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AS 21.34.180

Comments: The broker writes some multi-state policies. Three policies in the audit were multi-state risk and were reported as 100% to Alaska as Alaska is the home state of the insured based upon the principal place of business and at least part of the risk is in Alaska. As noted in #3, the other states were not identified on the Report of Surplus Lines Transaction

Results: Passed (error rate 0%)

5. Verify if tax and filing fee payments were made on time and by ACH

AS 21.34.180, 3 AAC 21.550 - .570

Comments: One of the eight payments due for the two year audit period was received late. The first quarter 2012 was due 6/1/12 but payment received 6/5/12. A penalty was assessed and paid prior to the audit.

Results: Failed (7 payments passed & 1 payment failed, error rate 13%)

Recommendation: It is recommended the broker revise their written procedures that include due dates for the quarterly reports and the associated payments.

Broker's response: Since the period under audit, the personnel responsible for making the quarterly filings and associated ACH payments have changed. One of the changes they instituted was to make the ACH payments farther in advance of the deadline, which should eliminate the chance of a late payment. PSF will update the Alaska Surplus Lines Filing Workflow to formalize this change.

6. Verify tax and filing fees payments were made accurately

AS 21.34.180, 3 AAC 21.550 - .570

Comments: All tax and fee payments made by the broker were accurate based upon the quarterly reports as filed. All payments were made by ACH as required. The errors found during the audit in the premium calculation and the accuracy of the quarterly report affects the accuracy of the tax and fee payments. These flow-through findings are addressed in their respective audit tests.

Results: Passed (error rate 0%)

7. Review diligent search effort made to place insured with an admitted insurer

AS 21.34.020, 3 AAC 25.010 and .035

Comments: The broker has elected to use the Affidavit of Due Diligence for documenting the diligent search. They are the producer in the transactions as well as the surplus lines broker. In six files, the Affidavit was created after the bound date of the policy. Several affidavits did not adequately identify the kind of insurance as on the placement list or have the correct effective date of the policy term.

Results: Failed (44 files passed & 6 failed, error rate 12%)

Recommendations: It is recommended the broker follow their written procedures to ensure all Affidavits of Due Diligence are created prior to binding including those with risks located on the placement list as required by Alaska law. Regulations changed effective 9/4/2014 that the documentation can be provided to the surplus lines broker up to 15 days after binding; however, the actual declinations and determination of the placement list risks must be done prior to binding. As the broker is also the producer, they need to create the documentation prior to binding. Another change in regulation is to correctly identify the kind of insurance to determine whether insurance coverage is available in the admitted market to cover the kind of insurance.

Broker's response: While PSF is aware of the recent regulatory changes allowing up to 15 days to provide the Affidavit of Due Diligence to the surplus lines broker, the errors listed under this section do not appear to have resulted from confusion over that change. PSF's training, guidelines, and workflows mandate that the Affidavit of Due Diligence is completed accurately prior to placement of a risk. This appears to be a problem limited to a few individuals rather than a widespread training issue, and supervisors will be addressing it with individuals accordingly.

8. Review disclosures on evidence of insurance for use of non-admitted insurer

AS 21.34.100(e)

Comments: Seven files demonstrated a problem with the required disclosure stamp and name of the broker on the evidence of insurance. Since the insured's copy is unavailable, auditor relied upon the broker copy. The stamp generally used by the broker includes the name of the broker and license number. There were times when a different stamp was used or where the wholesaler included it on the evidence of insurance so the broker did not duplicate the stamp. Here are the different disclosure problems found in the files:

- No stamp on policy - 2
- No stamp on binder - 1
- No stamp on endorsement - 5
- Broker name not on policy - 3
- Broker name not on binder - 2

Total disclosure errors: 13 within 7 distinct files

Results: Failed (43 files passed & 7 failed, error rate 14%)

Recommendations: It is recommended the broker ensure written procedures are followed that all evidence of insurance have the required disclosure stamp wording. It is further recommended to revise the written procedures to ensure the broker's name is included on all evidence of insurance.

Broker's response: It was recently discovered that the software that PSF uses to digitally store documents does not always "lock" changes such as the application of correct disclosure stamps onto a document. This glitch contributed to many of the errors noted, as well as some of the failures noted on Audit Section 12. The glitch has been diagnosed, and a solution has been tested and rolled out. Employees have received training on this section, and it has been added to the monthly internal audit to ensure that new procedures are being followed correctly.

9. Review notification for use of non-admitted insurer

AS 21.34.110

Comments: The broker generally includes the notification that the insurance is being placed with a company that is not regulated by the Alaska Division of Insurance in their proposal. There was one file for which the required notification was not part of the proposal.

Results: Passed (49 files passed & 1 failed, error rate 2%)

Recommendations: It is recommended the broker ensure their written procedures, which include their surplus line checklist, are followed to ensure the required notification is either part of the proposal or is provided to the insured prior to the premium being due and payable.

Broker's response: This item is of special concern to PSF as we hold ourselves to a high standard of transparency with clients. Recent internal training - conducted prior to the audit - stressed this item, and additional mechanisms were put into place to prevent this type of error

from occurring. This is a limited rather than systemic issue, and supervisors will be addressing it with the responsible individuals.

10. Confirm coverage is placed with an eligible non-admitted insurer

AS 21.34.050

Comments: All policies in the audit were placed with eligible surplus lines companies.

Results: Passed (error rate 0%)

11. Review notice regarding nonrenewal and premium increase

3 AAC 25.050

Comments: Three files did not have required Alaska Policyholder Notice of nonrenewal and premium increase part of the policy and no evidence of subsequent request for the notice. Several policies included the notice as a subsequent endorsement.

Results: Passed (47 files passed & 3 failed, error rate 6%)

Recommendations: It is recommended the broker ensure their written procedures are followed that includes a step of contacting the insurance company if notice not attached to the policy. Effective 9/4/14, regulation now states it is the broker's responsibility to ensure the notice is attached to the policy.

Broker's response: PSF's Policy Checklist (completed to ensure timely receipt of an accurate policy) includes the requirement that we review surplus lines policies to ensure they contain this notice. Staff follows up with issuing carriers on an urgent basis when policies arrive without the notice.

12. Review prompt delivery and required material facts on evidence of insurance

AS 21.34.100(a) and 3 AAC 25.060

Comments: This procedure was added during the audit due to non-compliance with promptly delivering the evidence of insurance to the insured (must be within 30 days of bind date or effective date, whichever comes first) and the lack of required material facts on binders and policies.

Here are the different issues that the broker is not compliant with regarding this statute and regulation:

- Prompt delivery – 3
- No premium on policy - 1
- No premium on binder – 2
- No tax on policy – 10
- No tax on binder – 8
- No broker license # on policy – 3
- No broker license # on binder – 2

Total errors: 29 within 19 distinct files

Results: Failed (31 files passed & 19 failed, error rate 38%)

Recommendations: It is recommended the broker revise their written procedures to include the prompt delivery of the policy or, if the policy is not available, a cover note, binder, or other evidence of insurance. In addition, the evidence of insurance must include material facts regarding the coverage, insured, insurer, and broker. Review statute for details on the material facts.

Broker's response: Prompt Delivery- PSF's Policy Placement/Renewal Workflow requires the delivery of binders within 30 days of binding a policy. The errors do not appear to be the result of systemic issue, and supervisors will be addressing these with the responsible individuals.

Material Facts - PSF's Commercial Alaska State Surplus Lines Workflow includes the compliant stamping of evidence of insurance. Several of the errors appear to have been the result of the software glitch noted for Audit Section 8. A solution, and training, has been implemented. This should reduce the potential for errors. In addition, a monthly internal audit procedure has been enhanced to include the review of the required material facts, which should catch any mistakes in a timely manner.

A "premium line" has been added to PSF's surplus lines tax and fee stamp, in response to format changes in some Underwriters at Lloyds of London binders/policies.

13. Workers compensation placed in surplus lines

AS 21.34.030

Comments: This procedure was added during the audit due to non-compliance with placing a workers compensation policy in surplus lines. One policy was for Maritime Employers Liability risk, which is considered workers compensation. There are additional steps the broker must have taken with the Division and an order signed by the director approving such placement before this policy should have been placed in surplus lines. As the coverage has since expired, the Division will not require the broker to retroactively seek an order.

Results: Passed (49 files passed & 1 failed, error rate 2%)

Recommendations: It is recommended the broker review the requirements in statute whenever it appears they may need to write a workers compensation policy in surplus lines. It would be beneficial to include this information in written procedures if there is a possibility of another such policy needing to be written in the future.

Broker's response: The additional requirements for placing coverage that is considered "Workers Compensation" on a surplus lines basis have been discussed and added to internal training for all staff.

File Documentation

1. The surplus line checklists continue to not be used as intended in some of the files. Some were not dated while others were dated but the dates didn't match when the item was completed sometimes months later. This shows a lack of accuracy when preparing the checklist and using it for its intended purpose. As the checklists are part of the broker's written procedures, these need to be used accurately.
2. One file did not have documentation showing when the binder was provided to the insured per AS 21.27.350.

Broker's response: Over the last two years, the personnel responsible for surplus lines training, internal audit, and compliance review has changed. PSF has also increased staff awareness that these individuals are available as resources for coaching as respects procedures and statutory requirements.

SUMMARY AND SUBSEQUENT EVENTS

Summary

This was the third premium tax audit of Parker Smith & Feek Inc. The auditor tested 11 procedures focusing on the broker's filing of quarterly reports and the subsequent payment of premium taxes and filing fees as well as diligent search, disclosure, and notification requirements for using a non-admitted insurer. During the audit two additional procedures were added due to other non-compliance noticed in the files.

The audit was conducted in the auditor's office as she reviewed electronic versions of the broker's files under audit. The broker responded quickly to all requests for additional information. The auditor appreciated this behavior.

Several significant issues did arise during the audit that affected the service to the insured and compliance with Alaska statutes and regulations.

- 1) The diligent search documentation of the admitted market continues to be created after binding.
- 2) Several disclosure stamps were missing from the evidence of insurance along with the name of the surplus lines broker.
- 3) Material facts of coverage were not found on many of the evidence of insurance and prompt delivery did not occur for several insureds.
- 4) A workers compensation policy was placed in surplus lines without obtaining an order signed by the director

The auditor would like to review any new or revised procedures to help the broker ensure all problems identified in the audit were captured accurately.

Re-Audit

In closing, the auditor's recommended actions and review of procedures should help the broker correct the problems encountered. It is recommended that Parker Smith & Feek Inc. be re-audited within the next three years to ascertain compliance.

Submitted by:
Rebecca Nesheim
Tax Auditor

Affidavit

Parker Smith & Feek Inc.
As of December 31, 2013
TA 14-02

Juneau, Alaska)
January 12, 2015)
State of Alaska) ss.
First Judicial District)

I, being duly sworn, do verify that the report of premium tax audit as of December 31, 2013 of Parker Smith & Feek Inc. is true to the best of my knowledge and belief.

Rebecca Nesheim
Rebecca Nesheim
Tax Auditor

SUBSCRIBED and SWORN to before me this 12 day of January, 2015

Parisa Feek
Notary Public in and for Alaska
NOTARY PUBLIC
My Commission Expires With office
State of Alaska