RMG CONSULTING
Claims and Risk Management Executives
www.insuranceaudits.com

650 Sentry Parkway, Suite One
Blue Bell, Pennsylvania 19422

1280 Route 46
Parsippany, New Jersey 07054

Phone 610-260-6080
Fax 610-260-6081
Email ggarris@insuranceaudits.com

Phone 973-394-1730
Fax 973-394-1734

INSURANCE COMPANIES
ADDRESS
CITY, STATE ZIP

COMMERCIAL INSURANCE DIVISION
SELF AUDIT UNDERWRITING REVIEW
DATE

Commercial Insurance Division
Self Audit Underwriting Review
DATES

RMG Audit Team: NAMES

Client Contacts: NAMES

AUDIT SCOPE

INSURANCE COMPANY Insurance Companies engaged RMG Consulting to review and evaluate the Commercial Insurance Division's self audit program. Based on the review the audit team would make recommendations to improve the INSURANCE COMPANY Insurance self audit program and the company's financial results. In preparation for the audit, RMG received a listing of enforce policies and selected a broad cross range of accounts by underwriter, agent, line of business and premium size.

BACKGROUND INFORMATION

INSURANCE COMPANY Insurance Companies is an insurance group composed of three carriers aligned in a tiered rate structure. Business written includes personal and commercial lines insurance written in two divisions. Operations are limited to the State of STATE. The group is rated "A" by A.M. Best & Company. The commercial division writes business through an independent agency force and a related producer source. Underwriting is under the direction of Beverly Ament, Vice President. There is a staff of seven underwriters, five assistant underwriters, an Assistant Underwriting Manager and an Assistant Vice President and Manager for the unit. All underwriting is conducted in CITY from the Bethel Street office. INSURANCE COMPANY Insurance staff adjusters handle all claims. Premium audit and Loss Control are also staffed by INSURANCE COMPANY Insurance personnel and report to Beverly Ament.

DATE Direct Written Plan is $AMOUNT estimated premiums by line of business are as follows:

Workers Compensation	$ AMOUNT
Commercial Package	$ AMOUNT
Automobile	$ AMOUNT
General Liability	$ AMOUNT
Umbrella	$ AMOUNT
Fire	$ AMOUNT
Inland Marine	$ AMOUNT
Bond	$ AMOUNT

New business goals for the DATE are $ AMOUNT. Renewal retentions are estimated at PERCENTAGE. The combined loss and expense ratio for DATE was PERCENTAGE The commercial division has an internal audit function conducted by the division's staff. In addition, INSURANCE COMPANY Insurance has an Internal Audit Department also responsible for auditing the activities of the division.

EXECUTIVE SUMMARY

This audit was conducted as a review of the current self audit program used by the Commercial Insurance Division of INSURANCE COMPANY Insurance Companies. The review team's audit confirmed that account selection and pricing were within the companies' underwriting guidelines with thirty-eight of forty accounts reviewed following established procedures. The review team also determined that the majority of business selected used updated information and followed underwriting procedures in place with the exception of twelve accounts, where the review team noted examples of old applications, needed updates of schedules of values, updated driver information and older financial data. There are procedures and guidelines that support the book of business written. The account files that were reviewed had the necessary information needed to underwrite and price the accounts when originally written. Over PERCENTAGE of the renewals used some form of updated information when underwriting and rating the renewals. This data, in some cases, was available from internal sources such as premium audit. The audit team found that an overall improvement is needed in the collection and analysis of renewal exposure information. In addition, based upon the policy files reviewed, additional premium could be generated through the effective review and updating of exposure data.

Documentation of the underwriting analysis and ultimate decision on the account was present, but additional updated documentation is needed to support the renewal underwriting process. The self audit documentation used by INSURANCE COMPANY Insurance on individual accounts was not reviewed however the general format for the self audits was made available. As a result of the audit, the review team will provide examples of account audit formats for review by INSURANCE COMPANY Insurance.

The audit team discussed both general underwriting issues and individual account questions with the Commercial Division management team during the audit. Management was able to speak to the general issues, and was familiar with specific accounts discussed during the audit. Overall, based upon the files sampled, account quality was considered to be good and the rating approach is adequate for the exposures used. Individual account pricing uses a manual rating approach, using INSURANCE COMPANY, INSURANCE COMPANY or INSURANCE COMPANY Premier Insurance Company rates. Experience rating was used on the majority of accounts reviewed, with credits applied for accounts written on package policies. There was evidence of loss control being used effectively, although it was noted that there were loss control reports four years or older in five files of forty accounts. Overall, the Loss Control reports were considered good and provided useful information to the underwriters.

Strengths

- Recognized presence in the market
- Experienced underwriting management
- Renewal retention rates exceeding PERCENTAGE
- Effective use of loss control services
- Knowledge of the business in the territory
- Good interaction with other departments

Areas Needing Strengthening

- Enhanced collection and documentation of exposure data each year
- Updated documentation of underwriting decision on current policies
- Improved documentation of referrals
- Documenting financial review of available information
- Improved file construction and maintenance
- Alignment of underwriting strengths to account assignment

REVIEW SUMMARY

Accounts Reviewed

Accounts selected for the review were chosen from data provided on the in force business written in INSURANCE COMPANY, INSURANCE COMPANY or INSURANCE COMPANY Premier Insurance Company. The accounts were selected using distributions by line of business, account size and underwriter assigned. The audit team reviewed forty accounts comprised of NUMBER policies. All accounts reviewed had effective dates within twelve months of the audit. Only active accounts were reviewed, no declinations or quoted not written accounts were audited. The accounts reviewed were, in most cases, renewals. Each underwriter had at least four accounts reviewed.

Risk Eligibility

Thirty-nine of forty accounts reviewed had information in file that documented the account to be in business more than three years, or the business owners had experience in similar operations. Additionally, it was noted that these accounts were written by INSURANCE COMPANY companies for more than three years, a recognition of the high renewal retention rate noted by INSURANCE COMPANY.

Loss information in files documented that although individual line of business loss ratios produced higher ratios, thirty-two accounts reviewed had a combined lines historical reported loss ratio less than PERCENTAGE, comprised either of INSURANCE COMPANY Insurance experience or a combination of INSURANCE COMPANY and prior carrier loss information. When accounts generated higher loss ratios, the review team found correspondence or documentation indicating that the accounts were referred to the next level of authority on a consistent basis.

The classifications used in the policies were in compliance with the Commercial Lines Underwriting Guide acceptable classes. With the exception of one account, workers compensation and general liability classifications agreed with the companion line of business.

Based on the underwriting authority information made available to the audit team, accounts were handled within the underwriter's authority or were referred as appropriate.

The majority of accounts were considered acceptable. However, in nine files out of forty accounts the lack of a current account summary document to support the underwriter's analysis and renewal decision and the overall condition of the files, made account reviews difficult.

Risk Information

Applications

Applications were found in thirty-nine of the files reviewed. The INSURANCE COMPANY Insurance procedures provide that an updated application is required every three years with exception of contractors where a renewal application is required annually. Applications followed the ACORD format and generally were complete. Applications in file were not signed by the insured and the producer in thirteen cases. There were five applications in file that were over three years old. Copies of the same applications were found in numerous locations including individual line of business files and control files, when used. The review team recommends that INSURANCE COMPANY Insurance applications should have the insured's signature on the application, or at a minimum, the signature or facsimile signature of the person completing the application.

Financial Information

Financial information is secured for larger accounts written. As an example, D&B reports were found in twenty-seven of the files reviewed. It was difficult to determine the analysis conducted of the information in the reports. In two files, the financial information indicated financial stress that should have been identified when the account was written. The Risk Evaluation and Documentation Form included a box for the D&B rating although this information was not routinely recorded. There were files that contained additional financial data such as audited financial statements. The audit team did not find conclusive evidence that the available financial information was compared to other risk information in the files to identify changes in operations or exposures.

The audit team was not aware of a formal procedure related to financial review. It is the recommendation of the review team that the Commercial Insurance Division develop a formal financial review procedure to be incorporated into the Underwriting Guidelines. Procedures should incorporate a guide to the analysis of financial data and be reflective of account size and industry. Based on the parameters used for the guidelines, a referral process should be incorporated based on individual account financial characteristics.

Updated Exposure Information Collection and Analysis

Our understanding is that the process for collecting updated underwriting and exposure information is triggered by a review of the account's updated application. The audit team was of the opinion that if the application was updated every three years, there were only limited attempts to obtain complete updated exposure or underwriting data in the interim. An exception to this observation was the annual requirement for contracting accounts to provide annual updated information. Obtaining updated renewal data varied by underwriter. There were files that contained correspondence to producers requesting verification of exposures to rate the next renewal.

The individual account information available within the INSURANCE COMPANY Insurance Companies is not used to the fullest extent possible. The high level of renewal retentions and the long term relationships with the accounts written provides a significant amount of data available to the underwriters that can be accessed from loss control, claims and premium audit sources to monitor and analyze exposures on an ongoing basis. In the example of premium audit, a number of files contained notices from the Premium Audit Department to underwriting regarding significant additional premium adjustments of at least PERCENTAGE or $AMOUNT existing policies. An adjustment was made to the audited policy; however, there was only limited evidence that the increased exposures were contemplated in the next renewal evaluation. The inaction on the current policy affects the rating and premium calculations for the policies enforce, but also impacts the complete analysis of the operations and monitoring of exposures for the account on an ongoing basis.

The audit team did not find annually updated Statements of Values for property exposures. Also, Insurance to Value calculations were not located in the files reviewed. It was also noted that automobile coverage did not have updated vehicle schedules in every file secured on an annual basis. The review team is of the opinion that automobile schedules should be obtained on all contracting accounts and accounts that have large vehicle schedules annually and that automobile exposures should be included the premium audit process.

During the review it was noted that the utilization of premium audit as a resource to underwriting for renewal exposures was limited. In those accounts designated as Service Accounts there was documentation of the Premium Audit Department participation in the service meetings. For accounts that were not designated as a Service Account, there was limited underwriting inquires to premium audit for verification on exposures for renewal.

The review team found limited cross checking of exposure information across lines of business.

Documentation by underwriting of historical exposure information was limited. The CPLR and Risk Evaluation and Documentation Form do not require that the historical exposures be documented with the premium and loss information captured. References to annual increases were premium related and did not address the impact of exposure increases to the premium. Underwriting should calculate rate increase for each renewal, adjusting the premium increases to reflect the change in exposures. The underwriting file should have documentation on what portion of the premium increase is true rate increase and how much of the increase is related to additional exposures.

Loss control reports were noted in the files reviewed. In three files reports were more than five years old. Current loss control reports were found for accounts generating larger premiums or were related to contracting exposures. Loss control reports were noted to be good with recommendations as required. On accounts noted as Service Accounts a Loss Control Department representative was involved with the service meetings.

Based on the audit team's review, underwriters did not use the most current exposures available when making renewal decisions. In the case of Workers Compensation and General Liability, exposures will be recaptured through premium audit and premiums will ultimately be adjusted. Other lines of business including Property, Automobile and Umbrella do not have the mechanism in place to capture changes if not initiated by the underwriter and this could result in understated premiums that may not be ultimately adjusted.

Operational Analysis

The files indicated that the operational analysis conducted by the underwriters primarily takes place when an account is first written. It was noted that subsequent renewals incorporate the original assessment with only limited changes even when the nature of the accounts changes or there is a significant increase in exposures. In four accounts, documentation of the underwriter's evaluation of coverage grants or increased exposures to loss was not fully addressed. It was noted that there was better documentation of exposures and loss potential when there was a large loss analysis.

The review team found that additional named insureds were added to the policies with limited supporting documentation and analysis. The nature of the relationship to the first named insured and the exposures to be covered when an additional named insured was added to the policy were unclear. It is the audit team's recommendation that complete information be obtained and evaluated prior to the addition of any additional named insured.

While the audit team noted that the policies contained a subcontracted work endorsement, outlining contractor requirements, it was often difficult to determine the underwriter's analysis of subcontracted work. A complete documentation of the subcontracting exposures and controls should be in the files.

Rating, Proposals, and Policy Construction

Pricing is accomplished using a tiered carrier rating approach. The premiums are modified by the use of NCCI experience rating and ISO based experience rating plans. No scheduled rating is used. A review of pricing indicated that experience rating modifications ranged from NUMBER to NUMBER. Rating worksheets were in the files reviewed. Accounts appeared to be properly classified. The files did not have a comparison of expiring rate to the renewal rate.

NCCI published experience modifications were secured and properly applied. Worksheets supporting the modification were in the files with the exception of one account, where the documentation was later provided by underwriting. General Liability and Automobile had experience modifications in file. When a package policy was used a package modifier of .85 was applied.

Formal Proposals were found for the initial year the account was written. The proposal provides good documentation of the limits, coverage and premiums by line of business. Renewal proposals were noted to be much less comprehensive and less formal in content, and varied by underwriter. The informality of the renewal proposals can lead to ambiguity and should be formalized. The audit team suggests that the format of the new business proposal also be used when quoting renewal business.

Polices construction was noted to be good. Larger accounts are written on a mono-line basis while smaller accounts used package policies. The policy issuing carrier was assigned based on individual account characteristics and assigned to the tier company best meeting the criteria. All policies had a forms worksheet attached for reference and as noted had rating documentation in the file.

Referrals

There were NUMBER accounts that had some portion of the risk subject to referral. Of these accounts, eighteen had some form of referral correspondence either for the current or expired year. In five of these accounts, it could not be determined from the information in the file if the referral was approved for the current year. It was noted that subsequent renewals do not require a referral for the area triggering the initial referral. With over PERCENTAGE of the accounts reviewed requiring some form of referral, the audit team was of the opinion that authority levels should be reviewed for the underwriting staff. The high number of referrals places additional levels of review work on the INSURANCE COMPANY management team.

Although the audit team did not have a formal referral procedure to review, the audit determined that the primary nature of referrals include premium size, loss ratio, or hazard grade for the line of business. When an account is referred for a specific issue, the entire account is reviewed as part of the referral. The Risk Evaluation and Documentation Form is the primary vehicle for the referral from the underwriter to the manager. It was not always clear from the file documentation if the there was an approval for each item subject to referral.

The audit team recommends that the referral process be further refined and documented. A procedure should be implemented to clearly define the referral requirements and the methods used to document any referral. The authority levels should be reviewed to align authority grants to the individual underwriter's experience level. Account assignments should be reviewed to determine if a strict adherence to a producer aligned account assignment maximizes the underwriter resources available. In particular, consideration should be given to having large accounts assigned underwriters who have exhibited effective management of large accounts. In a similar vein, industry specialists may provide expertise on an identified segment of the book.

File Construction, File Condition and File Maintenance

File condition was noted as needing improvement. The files were not segmented into defined areas such as Loss Information, Premium Audit, Loss Control, Underwriting, Applications, Rating, or Correspondence. Four files were found to be partially out of chronological order. Old information was in files that had no application to the current account underwriting. Multiple copies of the same documents were noted to be in the same file and often were found across the separate policy files for the same account, even with the use of a control file. The audit team suggests that a file construction procedure be developed for implementation that provides detailed instructions on file maintenance and construction.

Summary

The audit determined that overall account selection and pricing was considered to be good. The accounts written fit the guidelines as provided by INSURANCE COMPANY Insurance Companies. The review of the individual accounts found that the information in the files supports the underwriting decision, although the documentation is often a restatement of the original underwriting and pricing for the account.

The files often contained duplicate copies of material and contained information that is not related to the current policy period. A file construction procedure is needed to add consistency.

Underwriting authorities are followed but documentation needs improvement. Referrals need reaffirmation on renewal. The authority grants should be reviewed for possible adjustment based on the number of referrals that were found in the files. The audit team suggests that the assignment of large accounts be reviewed to maximize the experience of the staff.

INSURANCE COMPANY Insurance Companies outlined a plan to increase the marketing and production of larger accounts, while maintaining the traditional business model of writing smaller to intermediate accounts. The recommendations made by the audit team are intended to help in the transition, noting areas that should be addressed in all accounts and in particular larger premium accounts.

INSURANCE COMPANY Insurance's significant retention and commitment to underwriting profitability, when fully integrated with an effective underwriting and account management documentation, should continue to produce a solid book of business with good results.

RECOMMENDATIONS:

1. Exposure data should be obtained at each renewal. Updated Statements of Values, schedules of vehicles, payrolls and sales should be collected preferably through an updated ACORD or supplemental application annually. At a minimum, updated exposures should be requested in writing to the producer before the renewal is processed.

2. Underwriting should use all available sources to develop exposure information for accounts written. The information available in addition to producer derived data would include internal INSURANCE COMPANY Insurance sources including premium audit, claims and loss control. These sources should be assessed on a routine basis for all accounts regardless of size or service requirements.

3. The underwriting documentation and exposure analysis should be formally documented each year. The Risk Evaluation and Account Documentation Form should provide updated exposure analysis, past experience, risk analysis and the underwriting decision. This information should be documented each renewal with the appropriate underwriter signature and date.

4. A formal referral procedure should be implemented to clearly define the referral requirements and the methods used to document any referral. Accounts that require a referral based on underwriting guidelines and authority grants must be approved prior to quoting each year. All correspondence relating to the referral must be in file. Accounts that exceed a supervisory level authority should have the next level approval documented for each item subject to referral.

5. Financial Information in the form of a D&B report or other forms of financial data needs to have the underwriter's acknowledgement that the data has been reviewed. In those cases where the analysis of the D&B triggers the need for additional information, this data should be obtained from the insured. For larger accounts income statements or audited financials should be obtained and reviewed by an individual experienced in financial reviews.

6. A formal written proposal should be produced each year. The format should follow the outline used for new business quotes, with limits, coverage, and premiums by line documented to the producer.

7. A file construction procedure should be developed and implemented to add consistency to file construction and maintenance. The procedures should address the content of the files, file segmentation and what information should be carried forward at renewal.

8. An account assignment review should be undertaken to align the strengths of the underwriting staff to the accounts assigned. Consideration should be given to assigning the larger accounts to underwriting staff that have large account experience or have exhibited effective management of large accounts currently written.

9. The Underwriting Quality Analysis – Accounts Review Form should incorporate additional elements for reviewing accounts. The information in the review formats should follow the INSURANCE COMPANY Insurance Companies' policy and procedures that are documented and used by the underwriting staff. When the individual self audit results are consolidated and analyzed, management should determine any additional training that can be employed to improve the adherence to guidelines in place. Documenting results to track performance, focusing on areas for improvement for both the individual underwriter and the entire Underwriting Division, is a key element of a sucussful self audit program. RMG has provided suggestions for inclusion into the Accounts Review Form, which are enclosed as attachments to this report.

Additional Review

During the audit, we heard several times that Underwriting Managers do not have the type of reports needed to effectively manage the business. RMG Consulting, as part of the pre-audit work received two Excel files. One file contained, policy information on enforce claims. The second file contained claim data for the past four years. Based upon the need for immediate management tools to benchmark results, RMG has included a series of reports as a way to provoke discussion on what management tools would be beneficial to the Underwriting Managers. We offer these reports, at no charge, to provoke discussion, with six caveats:

1. This data has not been balanced to Accounting.
2. Our initial attempt to combine policy detail into account detail is not PERCENTAGE accurate.
3. Reports have enforce policy premium versus 18 months of claim data.
4. On some accounts we have claim data without having enforce policy information.
5. As we have not done a system review, we used the excel policy file exactly as provided. If a policy was listed 4 times on the excel file, we counted that as 4 policies.
6. We have included several reports to demonstrate data quality issues that need to be addressed before creating new management tools. We do not believe any of these issues are serious.

Initial Data Received

Exhibit 1 – Enforce Policy Listing – Sample Page
Exhibit 2 – Agency Assignments
Exhibit 3 – Auto, Package & GL Claim Data – Sample Page
Exhibit 4 – WC Claim Data – Sample Page

Reports Created

Exhibit 5 – Results by Account
Exhibit 6 – Suisan Group, Inc. (example of data quality issue of these initial reports)
Exhibit 7 – Review by Agent
Exhibit 8 – Servco Pacific (example of data quality issue of these initial reports)
Exhibit 9 – Results by Industry
Exhibit 10 – SIC 813930 (example of data quality issue of these initial reports)
Exhibit 11 – Results by Line of Business
Exhibit 12 – Review by Business by Size of Account
Exhibit 13 – Claim Data Received with no In-force Policy Information (example data quality issue)
Exhibit 14 – Results by Underwriter
Exhibit 15 – Monthly Workload by Underwriter

Again, our intention in providing these reports is to provoke internal discussion on what reports would be beneficial to the Underwriting Managers to improve the self audit process, managing internal workloads, and financial results. We realize until the information is balanced, and the data quality issues are fully understood, that these initial draft reports have limited value. However, based upon what we heard during the audit, we believe that supplying sample reports might speed up the time to develop useful management reports.