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INSURANCE CARRIER

Personal Lines Underwriting Review

DATE

By: NAME
Principal
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Audit Format

The audit team reviewed NUMBER policies using access to INSURANCE COMPANY's Windows on Property Casualty System along with information from the Documentum system. These policies were randomly selected and are distributed as follows:

Age	Dwelling	Homeowners	Auto	Umbrella
New Business	N U M B E R S			
1 to 5 years	N U M B E R S			
6 to 10 years	N U M B E R S			
Over 10 years	N U M B E R S			

The split of policies by Statutory Insurance Company is as follows:

INSURANCE COMPANY	NUMBER
INSURANCE COMPANYs	NUMBER
Total	NUMBER

In addition, the audit team reviewed policy applications that were declined but were stored on the Documentum system.

Underwriting Guidelines

Specific Underwriting Guidelines were developed for Insurance Company and for Insurance Company based upon the quality of risks and the corresponding rate level for the exposures insured. In theory, these guidelines were developed to apply to both new and renewal business. However, based upon the automatic renewal process, the Underwriting process is significantly different for new and renewal business. As a result, we will treat the Underwriting of new business separately from renewals.

For new business, to state the obvious, if these underwriting guidelines are not followed, then risks are not properly priced for the exposure. A risk qualifying for INSURANCE COMPANY Insurance but written in INSURANCE COMPANY is starting out with a premium that is PERCENTAGE% less than what the exposure warrants. When INSURANCE COMPANY premium credits and policy discounts are applied, this risk is a severely under priced risk. Simply put, the premium is not sufficient to cover the loss exposure. Further, this INSURANCE COMPANY insured will not look for another insurance carrier since the insured is unlikely to find a lower premium. This will work to keep the INSURANCE COMPANY retention level high but at a drastically reduced premium.

Of course the opposite is also true. If a true INSURANCE COMPANY risk is written in INSURANCE COMPANY, then the policy is overpriced and the insured is likely to shop for a better price and move to another carrier. This results in a lower retention rate.

Underwriting Guidelines for Renewals will be discussed as part of NAME OF SYSTEM.

As stated above, placing an insured in the wrong company has serious consequences. Further, given the number of policies being underwritten, it is impossible to get every insured every time in the right company. As a result, we will attempt to point out a few examples of a misplaced policy, and how procedures may be changed to reduce the risk of future misclassifications.

An insured written in INSURANCE COMPANYs Company with an older home and has not provided proof of renovation updates should be written in the INSURANCE COMPANY.

An insured with an at fault auto accident should be written in the INSURANCE COMPANY, if at all.

Once an at-fault loss on personal auto occurs, a process needs to be in place to be sure to switch the insured from INSURANCE COMPANYs to INSURANCE COMPANY. INSURANCE COMPANY has no reason to cater to undesirable risks in the very competitive auto market by retaining risks in the preferred company when they should no longer be considered a preferred risk.

Homeowner

The Homeowner credits available to an individual policy should be reviewed to determine if the total amount of credits being granted is excessive. A new Homeowner policy covering a newly constructed home will receive a PERCENTAGE Age of Dwelling Credit. This large credit is understandable if INSURANCE COMPANY Insurance is trying to gain market share by attracting the newest construction by offering a large initial credit and then reducing the credit after the first year. A PERCENTAGE premium discount is very attractive. This marketing tool can be very successful at creating a long term customer as both companies enjoy very high policy retention rates. However, other credits, such as for protective devices, will be added to this PERCENTAGE. As a result, the total credit may amount to a larger premium reduction than what is necessary to obtain new business.

For example, by year five, the age of Dwelling Credit has dropped to PERCENTAGE but the Customer Credit of PERCENTAGE now applies; resulting in a PERCENTAGE total credit. By year ten, the age of Dwelling Credit has dropped to PERCENTAGE but the Customer Credit has increased to PERCENTAGE; resulting in a PERCENTAGE total credit. Again, adding any other credits will reduce the premium further.

In order to ensure that no individual policy receives an excessive amount of premium credit, INSURANCE COMPANY Companies should consider introducing a Cap on total credits and discounts any given Homeowners policy can receive. Depending on the makeup of the book of business, a credit cap would not affect every risk but only those that have reached a total credit larger than INSURANCE COMPANY wishes to give. The individual credit / discounts could still be shown on the Declaration Page but when the cap is reached, a message would be included that maximum credit applies to this policy.

Other areas to review on the Homeowners policy include the following:

- Consider linking the Customer Credit with the risk's claim history.
- Homeowner Credits vs. Dwelling Fire Credits. Under the Homeowner program, a PERCENTAGE credit is given for a local fire alarm but the Dwelling Fire program gives PERCENTAGE.
- Consider reducing the number of rental properties eligible for Personal Liability coverage on the Homeowner policy to three. Separate Dwelling coverage would be required for any risk with more than three rental properties.
- The amount of Underwriting Authority given to Raters.
- Update the rules for accepting backdated endorsements up to one year, as listed in the referral criteria.
- Distinguish between premium bearing and non-premium bearing endorsements, with Manager Approval for premium bearing endorsements backdated over three months.
- The Homeowner Age of Dwelling Credit and the Customer Credit are not tied to the loss history of a risk, which should be changed.
- Backdated cancellations without supporting documentation can only be accepted with Manager Approval.

Insurance to Value is another area for further review. For Homeowners policies, we are concerned that the there may be a significant number of properties that are underinsured. One way to address this concern is to constantly remind customers that their property may not be fully insured. Depending on the amount of space available, a short Insurance-to-Value message printed on the insured's bill could be very effective. Two short sentences explaining in readable language the Coinsurance Clause and the benefit of discussing any recent improvement and renovations with their agent could be a simple quick and cost effective way of communicating the issue of being underinsured with the insured in a way that benefits the insured, the agent and the company.

We suggest that INSURANCE COMPANY consider sending out a yearly questionnaire to insureds regarding homeowner and dwelling fire policies. If INSURANCE COMPANY gets a response and the questionnaire is returned, the Underwriter gains some additional information about the Insured. On those accounts that do not reply to the questionnaire, INSURANCE COMPANY can select a percentage for a "drive-by loss control review".

There should be stricter INSURANCE COMPANY guidelines. The preferred company guidelines should be much tighter for a higher tiered company. Also, the Underwriter should switch an insured out of INSURANCE COMPANYs to the INSURANCE COMPANY if a significant loss occurs or the condition of property deteriorates. Also needed is the ability to change the payment plan to prepay is advisable.

In our opinion, there are to many high percentage credits. For example, Customer Credit should not be offered if the insured has had a loss. An insured with a loss will seldom switch insurance carriers because they have a higher premium due to a loss of premium credits.

Make sure each policy cross references the other existing policies on an account. This should be in the file notes. This currently existed on some files we reviewed.

Dwelling Fire

As with homeowners, the dwelling fire credits should be reviewed. The local fire alarm credit is a PERCENTAGE credit for a dwelling fire policy but the homeowners program only gives PERCENTAGE. Similar to Homeowners, INSURANCE COMPANY Insurance needs to review the credits to an individual dwelling fire policy so it is not an excessive discount.

Consider requiring an insured to place his homeowner's policy with INSURANCE COMPANY Insurance in order to insure the dwelling fire policy.

Many of the Homeowner topics are also applicable to the Dwelling Fire line of business.

- The same issue of insurance-to-value exists with homes covered under a Dwelling Fire Policy. This Policy often covers tenant occupied dwellings which may present a serious underinsurance problem. An Insured may be less concerned about the amount of coverage on the house since he does not live there.

- Review all credits given. Are the credits under the Dwelling Policy consistent with those given under the Homeowner policy? Under the Homeowner program, a PERCENTAGE credit is given for a local fire alarm but the Dwelling Fire program gives PERCENTAGE. What is the total amount of credits available?

- Consider adding a requirement that an Insured's primary home must be written in INSURANCE COMPANY or INSURANCE COMPANY when a tenant occupied Dwelling Fire application is submitted.

- Consider requiring Property Coverage under a Dwelling Fire Policy when liability coverage for Additional Residence Rented to Others is added to the Homeowner Policy. Then review the pricing of adding Liability coverage to the Dwelling Fire Policy and adding the Additional Residence Rented to Others endorsement to the Homeowner policy. Determine which option appears to be the more appropriate way of providing Liability coverage for a tenant occupied dwelling.

Auto

The acceptable reasons for non-renewing a Personal Auto Policy are very restrictive in STATE. Further, an insurance company may non-renew only PERCENTAGE of the total number of policies at the end of the previous calendar year in each of its rating territories. Such a limitation usually results in extensive tracking of non-renewals to ensure that this limit is not exceeded.

We were told that this limitation does not currently cause any problems for INSURANCE COMPANY Insurance because very few auto policies are non-renewed. INSURANCE COMPANY may want to consider revamping the Underwriting Guidelines and reunderwrite the auto book to increase the number of non-renewed policies written in INSURANCE COMPANY. This can be done in coordinate with increasing the frequency of ordering MVRs on renewals. Agents may be adversely selecting INSURANCE COMPANY because renewals are not reviewed frequently as the competition.

We are focusing this increased review strictly on INSURANCE COMPANY. INSURANCE COMPANY Auto has a high retention rate with a very good loss ratio. However, INSURANCE COMPANY's retention rate is significantly lower with a higher loss ratio. At first glance, we are concerned that some individuals in INSURANCE COMPANY are staying in INSURANCE COMPANY because of recent driving citations, which would be on their MVR.

We are also seeing some minor inconsistency in the discounts given to autos on Kauai. As a result, we have attached the corresponding documentation as Exhibit 7.

<u>Umbrella</u>

When writing an umbrella policy, INSURANCE COMPANY Insurance needs to make sure the insured has an inforce homeowners and auto policy. Based upon our review, we believe this procedure is being strictly followed.

The umbrella policy should cross reference the underlying policies. If one of the underlying policies should cancel, a UES referral should generate that mentions that the cancelled policy is associated with an umbrella policy. During our audit an umbrella policy was connected to a policy that lapsed and was rewritten. Careful attention should be paid to these types of circumstances.

Consider placing all umbrella policies under the INSURANCE COMPANY. Another option would be to consider changing the policy to the INSURANCE COMPANY from INSURANCE COMPANYs Company, if there is a lapse in underlying coverage, failure to pay premium in a timely manner, etc.

The Auto and Homeowner policies are required in order to write an Umbrella Policy and the Underwriting Guidelines contain the minimum Liability Limits for these underlying policies. Any endorsement requesting a decrease in Auto or Homeowner Liability limits must cause the Underwriter to review WPC and Documentum to see if an Umbrella policy is also written. We reviewed a file where the underwriter requested that the Auto Liability Limits be increased to the minimum required. The Auto Limits were increased, the Umbrella Policy was issued and then the Auto Limits were reduced back to the original limits.

Under the Umbrella policy number, WPC always contained cross reference to the Underlying policies. WPC for the underlying policies did not always contain a reference to the Umbrella Policy.

Underwriting Self Audit

The goal of the Underwriting Self Audit is to answer 4 simple questions:

(1) What is being done right,
(2) What is being done wrong,
(3) What should the unit do more of, and
(4) What should the unit do less of?

The benefit of the Self-Audit is to ensure that the underwriting process is consistently in compliance with Underwriting Guidelines as well as with state laws and regulations. The self audit process is a learning tool to sharpen the underwriting skills of all involved. The self audit process needs to look at the Underwriting procedures, as well as understand the rating procedures. It is important to understand how the computer systems are processing data input and how scanned documentation is filed. It is also important to determine what scanned documentation is actually used by the Underwriters as renewals are processed.

The self audit process should identify problems early and begin corrective action immediately, as this will lessen the impact that unresolved problems might cause if left unnoticed. Any flaws in the underwriting process, workflows and systems will become apparent in a well designed self audit. To be successful, all levels of management must understand these benefits and support this process.

The Audit should be completed by the Underwriting Supervisor and it is crucial for her/him to continually reinforce the benefits of this process. It is important that the audits be conducted in a positive manner where positive action is reinforced and negative action can be discussed and corrected. Employee feedback is used to develop specific improvement plans. Although Underwriting Self-Audits are currently being conducted, the current focus is more on Quality Control than on Underwriting

The Supervisor needs to objectively review the files, to be comfortable discussing the issues and be able to evaluate the training needs of the individuals involved. Initially, the attached Self-Audit checklist should be completed for each risk reviewed and, based on a number of broad categories, underwrite the risk and determine if it is the underwriting and the risk are judged as satisfactory or unsatisfactory. As the Supervisor and the Underwriters become comfortable with the review process, the rating should change to actually rating the Underwriter on a scale of 1 – 5, with 1 being a complete file that was handled properly and 5 being a risk where information is missing and underwriting incomplete. Eventually, the results of these reviews should be included in the Performance Appraisal process.

A sample size of NUMBER files should be taken each month from the current work of the Raters, Underwriter Trainee and Underwriters making sure that new business is included from each applicable position. The review should emphasize the need to underwrite an entire account rather than just one line of business. Account underwriting should result in reviewing all transaction types, including endorsements, cancellations and renewals for each line of business as well as reports (inspection, CLUE, MVR) and UES referrals. Declinations, Nonrenewals and Notices of Cancellation should also be part of this review process.

Once completed, the results of the review should be discussed individually with each person reviewed. This should be used as a training tool which provides the employee with the opportunity to review and clarify any areas of dispute. The overall results should be shared with all employees reviewed.

For subsequent reviews, the samples should focus on the specific areas of concern as identified in the prior Underwriting Self Audits. . Also stress areas of strength to keep it positive. The Self-Audit results should be monitored for trends in file handling that may require additional training and education as well as processes or procedures that need to be changed.

Files should be reviewed on an ongoing basis with the results compiled in a Quarterly report to Management. See attached report which recaps the number of files reviewed with the number that were satisfactory and unsatisfactory. The unsatisfactory risks are broken down into major categories. Specific recommendations must be made for each unsatisfactory category listing underwriter involved and time frame for carrying out the corrective action.

Again, the person that performs underwriting reviews and data quality reviews needs to review the work for each underwriter, including reviewing each transaction type for Homeowners, Auto, Dwelling Fire and Umbrella policies. The Personal Lines supervisor needs to have a thicker skin when reviewing for data and underwriting accuracy, and needs to be honest about what might have done differently on an account, and why.

To restate what was noted above, the purpose of the self audit is to improve overall accuracy, quality and understanding. Communicate with employees as the results are published, the high level results of the monthly self audit, the positive results are first. List the overall strengths of the underwriting process. For employee morale, it is always better to give the good news first. However, there is a more important reason to communicate the good news first. This is the best way to reinforce that something is important, and that this part of the process is being done. This is the best way to ensure that what was being done well last month, will be done well again next month. After documenting the positive results, list the weaknesses that the self audit uncovered, where improvement is needed, and how progress will occur. The Personal Lines Supervisor should outline a course of action to implement the improvements. Make sure to communicate to employees that these changes are to make everyone ‘work smarter’ and more efficiently to keep up with changing business needs.

The Personal Lines Supervisor sets a realistic timeline to achieve the improvements, measuring results against track goals on a monthly basis to quantify results.

With improved self audits, the book of business will include the more desirable risks and anyone looking at the file will have complete information. What this means to INSURANCE COMPANY is they will understand more about the book of business they have and what they need to improve in their underwriting skills. The bottom line to INSURANCE COMPANY is they will have more profitable business.

Follow up is a very important step in the self audits. If a file is lacking information, it is crucial that the underwriter follow up to obtain that information to document the file. This does two things. First, it gets the missing information, and second, it reinforces the need to get the information with the Underwriting. Also, do not just send a letter requesting information. Set a diary date to follow up to make sure the information was received.

Expanding on the issue of following up on missing information is very important. First, it is an area we identified in our onsite audit. Second, the diary note for follow-up is often recorded by Underwriter in their personal outlook calendar. At the present time, most follow-up notes are in Outlook, some are in the system, and in some cases we believe the follow-up note is recorded in the system and in Outlook.

Recording the diary note in Outlook is fine, if it helps an Underwriter remember to follow-up. However, the WPC system is the “system of record”. A diary note for follow-up should always be in the system of record, recorded in a consistent, predictable manner. Following up on open items is one area that can be improved upon.

<u>Homeowners</u>

Areas within the Homeowner’s policy to be addressed in the self audit include the following:

1. Insurance-to-value - Underinsuring the Dwelling or any covered structure causes problems for the insured, the company and the agent.

   The insured may be faced with paying part of a covered loss. The standard Loss Settlement of the Homeowner policy contains a co-insurance clause which restricts the amount of coverage available at the time of a loss if the insured hasn’t insured the property to at least 80% of the replacement cost. The Company will not pay more than the limit of liability that applies to the dwelling or other structure.

Insurance to value is particularly important when the Added Value Replacement Cost – Building endorsement is part of the policy. This endorsement removes the standard co-insurance clause and the company agrees to pay up to 1PERCENTAGE of the building coverage if a loss exceeds the Coverage A or Coverage B limit of liability. The insured is required to notify the Company of alterations that increase the replacement cost of the dwelling by PERCENTAGE or more and to repair the damaged building. If the replacement cost is not accurately established, the Company is at risk of paying up to PERCENTAGE more than the dwelling limit of liability.

A big concern within the self audits is insuring to value and the affect this has on the claims process. If the home is not properly insured to value, an insured may have a loss that is not completely covered. The alternative, if the insurance to value is not properly documented by the Claims Department, INSURANCE COMPANY will end up having more total losses than normal. This is because a partial loss, by a fire for example on a dwelling significantly underinsured, can cause enough damage to be equal to PERCENTAGE of the insured value.

As previously discussed, if an insured does not understand the necessity of increasing the dwelling coverage on a homeowners policy to a realistic amount of the value, INSURANCE COMPANY needs to make sure that he is educated of the downfalls of being underinsured. Enclose a mailing flyer with every homeowner's policy stressing the reasons for insuring a dwelling to full value and the repercussions that can occur if a dwelling is not insured to value and the insured submits a claim under the policy.

2. Condition of the building

3. Location of the building

Dwelling Fire

Similar to homeowners make sure that documentation of the most recent renovation updates are made. The underwriter should include the condition of the property in the file. Consider having a recent photo (every 5 years) in file depicting the condition of the property. Rentals tend to depreciate faster than an owner occupied home. Generally speaking a homeowner shows pride of ownership. Renters typically are not as concerned with keeping up the condition of the property

Areas within the Dwelling Fire policy to be addressed in the self audit include the following:

1. Insurance-to-value. As with the Homeowner policy, underinsuring the dwelling or any covered structure on a Dwelling Fire policy causes problems for the insured, the company and the agent.

   The Loss Settlement Clause of the Dwelling Fire Policy contains the same co-insurance clause as the Homeowner Policy. The amount of coverage available at the time of a loss is restricted if the property is not insured to at least 80% of the replacement cost. Since the Company will not pay more than the limit of liability that applies to the dwelling or other structure, an insured may not have adequate coverage at the time of loss.

2. Condition of the building. This takes on more significance with Dwelling Fire Policies because the dwellings are often tenant occupied and the insured may not have the direct control over the condition of the dwelling.

3. Location of the building

Auto

INSURANCE COMPANY needs a new strategy to be more self critical at the Auto book of business, and develop new procedures to non-renew as close to two percent of the book very year as possible. We believe the best place to begin this new review is the self audit process. The reality is the STATE an Insurance Department has set the two percent limit for a reason. If INSURANCE COMPANY does not continuously clean its books, we are concerned that ultimately INSURANCE COMPANY will have more bad risks than the competition, excluding those companies that look for the non-standard business.

INSURANCE COMPANY can use the information generated from the UES system and claims in a report format by expiration date, with enough advance notice, to get off some of the unacceptable auto book. The unacceptable auto book includes policies with at-fault losses.

Again, INSURANCE COMPANY needs to work to get some of the 'bad' business off of the books, in order to maintain competitive standards with their competition. In theory, this process should lead to a slightly more profitable book of business. INSURANCE COMPANY is currently non-renewing less than one percent of the auto book. INSURANCE COMPANY is able to non-renew more auto policies but currently does not non-renew up to the maximum acceptable level that is allowed. When INSURANCE COMPANY runs a MVR that reveals an at fault accident, then the Underwriter needs to re-evaluate this risk to determine if the account should be cancelled or moved from the preferred company to INSURANCE COMPANY. Also, the policy should be diaried for nine months to set the non renewal for the following policy period.

Umbrella

Areas within the Umbrella policy to be addressed in the self audit include the following:

Check that the underlying policies have the minimum required limits. Also, ensure that these policies are inforce. I came across a situation where a policy lapsed and was rewritten in order to rewrite the umbrella.

The minimum Liability Limits of the underlying policies must be maintained or the Umbrella Policy must be cancelled. If a Liability loss occurs and the underlying Auto policy limits are below the minimum, the Umbrella will not act as an underlying auto liability policy and provide coverage for this gap. The Umbrella Policy will not be triggered until a claim for damages exceeds what the insured should have carried as underlying insurance.

All Lines

Areas that need to be reviewed for all Lines of Business include the following:

1. Corrective action taken - Did the underwriter review all of the information provided and come to an acceptable underwriting decision? Were discrepancies noticed and documented with sound underwriting judgment? Was missing information obtained? Were exceptions warranted? Did the underwriter make proper use of the new business Underwriting Experience Period? Does the underwriter show a clear understanding of what information is important?

2. Correspondence / Communication with the agent - It is impossible to correctly evaluate a risk without complete information. Correspondence should give the agent a reasonable time frame in which to provide missing information. If the agent and/or insured will not cooperate by providing the requested information, then the risk should not be written or renewed. A reliable diary system must be used to make sure that incomplete risks aren't inadvertently renewed.

3. Data Quality - Accuracy has to be a priority. Transactions that are entered incorrectly cost the company money by requiring a second entry with the correct information and another mailing. If the incorrect transaction involves a premium, the company may have lost money by not obtaining the correct premium initially for the exposure. The cost of poor data quality is rework. Any cost study will show that is it more expensive to do something twice, correcting the initial error and then doing the work correctly the second time, than it is to do it right the first time.

4. Account Underwriting – It is important to know that an agent has not placed an entire account with INSURANCE COMPANY, and to attempt to find out why an agent did not place the entire account with INSURANCE COMPANY Insurance. The reason could be that the other line of business does not qualify for either of INSURANCE COMPANY's, the rate level for the other line of business is not competitive or that INSURANCE COMPANY is being adversely selected against. Again, the Underwriting Self Audit process is an attempt to review the entire process, not just the actions of the Underwriter.

5. Referral Criteria - Authority levels are established based on the Underwriting expertise of that level. A risk that fits the referral criteria but isn't referred is unacceptable underwriting. Although an individual risk may not have presented a great exposure, if authority levels are not adhered to there is a greater potential for an unacceptable exposure to be overlooked.

Being uncompetitive and being adversely selected against are major issues that need to be addressed in future plans.

Underwriting Expert System

While the current UES may have seen its better days, the system "is what it is" and the Personal Lines Underwriters need to work within its constraints. The current system has line of business specific rules for Homeowners, Auto and Dwelling.

Trigger Underwriting Expert System (UES) to generate a loss report monthly showing policies 3 months in advance of expiration dates with losses in the past year. If more than 1 loss in the past 5 years, have UES trigger in report the total losses last 5 years per policy. The UES rules need to be reviewed and revamped.

Evaluate if additional UES referrals should generate when doing self audit. Also, note the unnecessary referrals generated. Determine what the good referrals are for New business, renewals endorsements etc. Break down each referral by transaction type and line of business. A referral that may be pertinent to a new business policy may not be necessary for the renewal policy. Update what should refer and what should not refer on a quarterly basis with the CGI – Inspire vendor.

Reports

Generate reports for homeowners listing losses by agent code, amount of claim etc. The Underwriter should get a report weekly or monthly listing the accounts that had a loss for the month. The report should list the expiration date, policy number insured name, etc. This will enable the Underwriter to do a timely review to diary prior to expiration if a decision is made to non-renew the policy or change the company from preferred to standard.

In theory, INSURANCE COMPANY should be able to generate a report for homes built over 10 years ago, listing the renovation updates completed and the year completed. In practice, INSURANCE COMPANY is going to have to conduct a review to determine the number of unreported renovations.

Maintain an index to reference Homeowners and Dwelling information by address, block and lot number, not just insured name and policy number. This way information about a specific location can be assessed when a property is sold, and new owners submit a new application for insurance. In addition, this type of reference would be useful to determine density, which is the number of risks insured on a given block.

Need reports listing policies up for expiration within 3 months and include number of losses and UES referral if applicable. This way these accounts will stand out enough to allow the underwriter enough time to review.

Also reports listing homes policies by expiration dates and list out all older homes with the latest dates of all their renovations.

Generate an accounting report listing total reminder notices going out in a month, late notices, insured name, policy number, and expiration date.

Generate a report listing on each account, listing the premium, the losses, open and closed. The underwriter should want this information upfront, as they review the accounts with losses. This will initially be done to see if they want to continue to renew the policy or if it is time to get off the account by non-renewing or moving an account from the preferred company to the standard company.

Systems

INSURANCE COMPANY can reduce costs by reducing the number of pay plans and even combined the pay plan for all policies for the same account. Less paper would be generated and this should be a substantial savings.

The WPC needs to show all activity and documentation on the account. The image maybe be recorded in Documentum, but WPC needs to record that the activity has occurred. Also, INSURANCE COMPANY needs to utilize WPC in a consistent manner to create a reasonably acceptable diary system to ensure that key issues are addresses on each account, and to be able to flag the underwriter to review the risk.

INSURANCE COMPANY's documentation systems will not be complete for sometime. In theory, the policy application should be in the imaged file. Any person should be able to find all the information on an insured easily and in one system. However, in practice, that would be cost prohibitive. As a result, this risk needs addressed though a separate management auditing process, discussed later in this report.

Claims Review

Losses must be reviewed for frequency and severity; severity of the current loss as well as the severity potential of the loss.

A risk that was loss-free for first ten years, and then had two small losses in the last three years, may still be profitable. However, these recent small losses may indicate that the original exposure has changed, and there is a greater potential for a severe loss. For example, a small water damage loss may lead to a large mold loss.

Although imposing a higher deductible may seem like a way to eliminate these small losses, it does not eliminate the potential for a severe loss but it does reduce the policy premium. Further, contractors will often cover the deductible when putting together an estimate of damages to be submitted as an insurance claim.

By reviewing the small losses, a larger exposure may be identified that leads to non-renewing a certain risk, or taking corrective action to reduce or eliminate the chance of future losses.

File Documentation

In order to properly evaluate a risk, the Underwriting file needs to be complete. WPC should contain a notation of every phone conversation and the thought process of every action that is taken but not evident from looking at the scanned transactions. In addition to every policy transaction, Documentum should contain every piece of correspondence mailed and received. Taken together, WPC and Documentum should contain all activity concerning the insured risk. Without a fully documented file, no underwriting decision should be considered acceptable.

Scan all documentation for the referrals into Documentum. This would include any correspondence with the agent for further information. It is crucial for the file information, especially the underwriter information, be easily accessible in case another underwriter receives a phone call on the account.

Declinations

With better file documentation and reports, the underwriters will be able to be more proactive in determining what risks, should be declined, cancelled or nonrenewed.

We reviewed NUMBER applications that were declined and all but one was fully documented with sound underwriting judgment. The exception was a Dwelling Fire application returned to the agent with the instructions to rewrite the risk on a Homeowner Policy and a suggestion to notify the insured to get rid of the trampoline in the photos since this was a liability exposure that carriers do not want.

Removing the trampoline eliminates the exposure at that point in time but does nothing to prevent the same or a similar exposure in the future. This risk should have been declined.

Amending the policy form wording to specifically exclude liability exposures such as trampolines or swimming pool diving boards may not eliminate the Company paying a liability loss. Such exclusions have to be tested in court. The more prudent action is to decline the risk.

Re-Underwriting

Based upon our review, we have a concern that INSURANCE COMPANY Insurance may not know the exposures in the Personal Lines book of business as well as their competitors. Granted, our review is biased by two issues:

(1) We are outsiders to INSURANCE COMPANY Insurance and to STATE, and we do not know the territory as well as "a local", and

(2) Documentum only has complete policy information for recently added business, and follow-up diary notes are often kept by the Personal Lines Underwriters on their Personal Computers in Outlook.

This being said, we saw no evidence of INSURANCE COMPANY Insurance knowing the percentage of business that was most likely underinsured based upon low inflation rates used in the past to increase Dwelling replacement costs, we saw no indication of how many renovations / improvements have gone undetected, and we saw no communication / summary report from claims documenting how many Homeowners claims were reduced because of insurance to value calculations.

A Homeowners or Dwelling risk that is acceptable as new business but is never endorsed and has no activity that triggers a UES referral can renew for years without any underwriting intervention. We are concerned that this has resulted in an undervalued book of business and exposures have not been increased enough to reflect actual exposures.

At this point in time, we can not conclude that under insured properties are risks to INSURANCE COMPANY Insurance. Likewise, we saw no evidence that can be used to conclude that this risk is minimal.

Rather than re-underwriting the entire renewal book, pulling a small number of renewals, such as NUMBER accounts, and requesting that Loss Control take a picture of each Dwelling will provide the underwriter with a look at the current building. A picture can show new liability exposures, additions made to the house, the condition of the roof and the general upkeep of the property. Upon completing a review of information gathered by Loss Control, the underwriter can make a determination if the dwelling value is reasonably correct, whether the risk is still acceptable, and if the account is written in the correct company. The results of this review will determine whether a full reunderwriting program would be beneficial.

Profit & Loss

While outside of our review, this is an area we believe is worth commenting on. Our review of Profit & Loss issues can be divided into 2 areas; Expense Management and Accounting Entries.

Expense Management

Managing expenses is always important. However, in a transactional heavy business such as Personal Lines, managing expenses is critical. To manage expenses, an organization first needs an "Expense Awareness" thought process, a review of every activity to see if the work is needed, a way to reduce the number of transactions, and a way to more efficiently process those transactions that need to be done.

Expense Awareness – During our audit, we asked two questions regarding financials. One of those questions was "what is the split between fixed and marginal costs". This question was designed to be the opening to a series of questions that will be developed over time.

- What are the fixed costs?
- Are those fixed costs truly fixed?
- What are the marginal costs?
- How does a change in activity affect those marginal costs?

While answering all of these questions is outside of our review, we can at least begin the expense awareness process of the last question. How does a change in activity affect those marginal costs?

During our audit we came across a number of insureds who did not pay their insurance bill on time. INSURANCE COMPANY needs to pull a listing of accounts that consistently wait for pending cancellation notices before paying the premium. A report detailing these insureds that have a habit of paying late, causing cancellation warning notices, cancellation notice, and a reinstatement notice can probably be generated from the Accounting Department. As a result, we suggest that INSURANCE COMPANY reduce the number of payments for insureds that consistently pay their bills late. Create three strikes and you are out process for consistently delinquent insureds. Again, stop offering pay plans to insureds that consistently wait for the pending cancellation notice for nonpayment of premium. Get the money from those insureds as prepaid upfront to avoid default risk. Also, remove any accounts from the INSURANCE COMPANYs Company if they do not consistently pay their bills on time. A three strikes and an insured is out of INSURANCE COMPANYs procedure would take care of this issue.

Reduce pay plans, and increase the minimum payment on new business and renewals from $30 to $100. While INSURANCE COMPANY is currently reviewing increasing the installment charge, we believe the better way to deal with this cost is to reduce the number of transactions. We believe the simplest way to do this is increase the minimum payment.

Consolidate pay plans for all lines of business to make it more user friendly. Offer Electronic Funds Transfer (EFT) or credit card pay options. Offer incentive to pay the entire insurance premium at once by saving the multi-payment transaction fee.

Request more deposit premium up front for all lines of business. This will reduce the costs of collecting the remaining amount, and very marginally increase investment income. We suggest that INSURANCE COMPANY increase deposit premiums for new auto policies. Simply put, Auto is a tough book and there is no reason to take on collection risks on this line of business.

The message is simple: “Look for new ways to save five dollars on every policy, every year”.

As a related note, Acquisition Expenses are an important part of the Underwriting profitability puzzle for Personal Lines. Our understanding is that Acquisition Expenses were $8.5 million for Personal Lines in 2005. Further, with technological advances, the direct writers are going to gain even a larger presence in the market. As a result, INSURANCE COMPANY is faced with two direct issues:

Taking on the costs of increase market share with the independent agents is an expensive but necessary action. Direct writers will increase market share, taking share from the independent agents. This will require INSURANCE COMPANY to give better Profit Sharing plans, have better contests, do more marketing with the agents, and make it easier for the agent to do business with INSURANCE COMPANY. For example, INSURANCE COMPANY will have to do more of the Loss Control process on the Personal Lines book of business to streamline the process.

Based upon our limited understanding of Atlas, we believe they can increase market share. However, this will require three new initiatives:

(1) Installing the same technology as direct writers are currently using. In theory, this technology can be used as a direct writer or to offer competitive quotes from multiple companies.

(2) Better marketing. While we acknowledge we are not “locals”, we did drive around the INSURANCE COMPANY, we did read newspapers, and we did watch some Television. We do not recall seeing any Atlas advertising. Also, Atlas can market to local influence groups, such as the local Real Estate Agents. For example, the Commercial Lines Division could create a package policy for Real Estate Agents at the same time Atlas aims a marketing campaign at the agents on why INSURANCE

COMPANY's Homeowners polices are better for their clients. Coordination is the best way to increase overall awareness.

(3) Streamline procedures between Atlas and INSURANCE COMPANY. One way to do this is too cross train personnel between Atlas and INSURANCE COMPANY. This concept is discussed later in this report under training.

Accounting Entries

Again, during our review, we asked two questions regarding financials. One area was about expenses, which were covered above. The second question dealt with a significant difference in IBNR for direct and ceded losses. As that question has most likely been answered by now, we will not go over the issue in detail. We just want to reinforce the message; the financial numbers need to be understood by Profit Center Managers.

For purposes of this discussion, financial numbers can be separated in three broad areas:

Direct allocated – Losses booked against policies and salaries of Underwriters. These are hard numbers directly attributable to an activity, such as a loss incurring or hiring an additional Underwriter.

Allocated – These entries include shared expenses. The key question for this category is (1) what can be done to reduce these costs, such as send out fewer billings notices, and how does this reduce cost get booked. Reducing costs and seeing those reductions reflected on the P & L are two separate questions.

Financial – IBNR calculations and investment income are examples of how a small change in the way these numbers are determined can have a very large impact on the bottom-line on the Profit and Loss statements.

Again the message is simple: “Know your numbers”.

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Other Noteworthy Areas

Three noteworthy areas that fall into a miscellaneous category are as follows:

1. Customer Calls
2. Succession Planning
3. Training

Customer Calls

Most of the underwriters at INSURANCE COMPANY stated that they spend a good portion of their workday answering customer calls.

INSURANCE COMPANY's Personal Lines Manager needs to understand what types of calls are coming in. Decisions then needs to be made on either how to efficiently reduce the number of calls coming in to the underwriters, or to use these calls to promote INSURANCE COMPANY's marketing campaign. Simply answering the question is not enough, if the work (read: cost) does not generate additional business. There should be a log recording every phone conversation with a customer. This log should include detailed information. See the exhibit on following page. The log could be in paper form or system form. Compilation of this data can give the Personal Lines Supervisor valuable information to see if there is a trend in the types of questions asked by the agents. INSURANCE COMPANY can send a quarterly two page newsletter to the agents addressing the frequently asked questions. This could help eliminate some of the future calls.

All calls into the office should be designated a problem number to associate with the question. The question should be tracked to see how long the item was open, when it was closed and what the actual resolution was. The tracking of all these issues will assist in identifying which calls are taking up the most time and how they can be eliminated. It is crucial to document and scan every underwriter call regarding an account.

The tracking will also help to identify which agent calls in the most. Is there an underwriter that seems to handle an excessive load of calls? This information is valuable to improve workload efficiency. The information that is tracked from those calls is information that can be used to decrease the amount of calls received in the future. Tracking of the calls will also help prevent agents calling and speaking with multiple underwriters on the same question.

Succession Planning

While outside of the scope of our review, we do see this as a business risk. If someone goes out on an extended leave, you need to know who can take over that workload. All underwriters should be cross trained on the different aspects of their individual jobs. The idea is anyone could fill in for a person who unexpectedly goes out on leave.

<u>Training</u>

To state a very basic management function, it is very important to keep the lines of communication open. Management should give an overview of the various changes that are going to happen. Management should also stress that the adaptability to change is crucial to profitability and career development. Stressing that a good idea submitted that saves the company money will be rewarded.

While the above is “obvious”, we want to re-stress how important these things are to INSURANCE COMPANY.
INSURANCE COMPANY does not have the amount of personnel change “Mainland” companies have. This helps keeps a predictable environment. However, personnel change also brings with it new ideas, and ways of thinking. As a result, INSURANCE COMPANY needs to concentrate on bringing in new ideas. There are two ways to do this, encourage new ideas and cross train.

We see the most effective way to cross train is to build an employee development model with Atlas. Under this model, an employee’s growth (read: promotion) would be from INSURANCE COMPANY to Atlas and than back to INSURANCE COMPANY. This accomplishes several things. One develops an Underwriter to see the world from the agent’s and insurance companies’ point of view, allows for more advancement stages, and should improve both communication and workflows as employees would understand both companies’ workflows.

Competitive Analysis

Enclosed for your review are several noteworthy items:

We found the Competitive Rate information from STATEan Insurance Department to be very useful. According to this information, INSURANCE COMPANY appears to be among the lowest cost insurer in Oahu for a Homeowner's policy. Further, INSURANCE COMPANY has a lower cost than GEICO for an Oahu insured with a clean driving record. Given that GEICO is a direct writer and a INSURANCE COMPANY insured is using the expertise of a local agent, we would have thought INSURANCE COMPANYs' rates would have been higher than GEICO's rates.

A declination of Property Application, with a note to get rid of the trampoline in the photos and resubmit as a HO3 application is enclosed.

Declination letter related to Fairmont. Our understanding is that Crum & Forster has acquired Fairmont, and is currently submitting rating information with the Insurance Department of STATE to move these insureds onto a Crum & Forster "A" rated insurance company, at the same rates currently offered by Fairmont's lower rated company.
As a related issue, we believe this insured, with a moving violation, should be placed in INSURANCE COMPANY and not INSURANCE COMPANY.

We thought the Personal Lines Management team might like to see the TIG Premium credit worksheet along with the acknowledgement of Hurricane Coverage Exclusions offered by TIG and AIG.

Premier

As a result of our audit, our opinion is that INSURANCE COMPANY needs to restructure their Underwriting guidelines for the INSURANCE COMPANY and INSURANCE COMPANYs Companies prior to creating a new company, Premier, for personal lines business. Further, as stated above, we believe INSURANCE COMPANY needs to know more about the current book of insured business. To deal with both of these issues, we suggest undertaking an extensive reunderwriting review of 60 accounts.

We believe this very small sample should be enough to build the model. We offer the following step by step process to provoke discussion on how INSURANCE COMPANY can go about this process:

1. Review 60 insureds for all their lines of business, including Loss Control taking pictures on drive-bys.

2. Re-determine if the account should be in INSURANCE COMPANYs, INSURANCE COMPANY or non-renewed.

3. Re-rate the policies, taking into account all current information, including updated, estimated replacement costs, current MVRs, etc.

4. Review these 60 accounts to determine how the risks would be divided into three companies. Update the Underwriting Guidelines as a draft version to reflect these new rules.

5. Determine new rates for the companies, most likely keeping INSURANCE COMPANY and INSURANCE COMPANY rates in place, and “sliding in” Premier rates between the two existing companies.

6. Undertake a second sample.

7. Review the risks of this second sample; decide what company would be used. Reunderwrite and re-rate the risks based upon the new drafted Underwriting Guidelines and the new proposed rates.

8. Use these results as the basis of determining the effect of a third company on INSURANCE COMPANY’s overall book of business.

9. If this small sample shows that risks today are properly priced, Underwriting Guidelines can be restructured to allow for three companies, the new Underwriting Guidelines are clear enough to be communicated to agents, and the financial results are acceptable; than a plan can be drafted to implement a third company.

We realize that the suggestion of doing additional review may not be what was hoped for. However, with (1) so much of INSURANCE COMPANY's Personal Lines book of business not currently stores in Document, (2) with the UES rules needing to be updated, and (3) with so much of INSURANCE COMPANY's current of business possibly underinsured, we can not recommend moving forward until these three areas are addressed.

A NUMBER% rate difference between INSURANCE COMPANY and INSURANCE COMPANY Companied does allow for the creation of a 3rd rate level between these companies. However, the similarities between the Underwriting Guidelines for INSURANCE COMPANY and INSURANCE COMPANY appear to prevent developing guidelines for this new company. Therefore the work needed is in drafting new underwriting guidelines. However, again, we recommend that INSURANCE COMPANY gain additional insight into the current book of business before undertaking redrafting the current Underwriting Guidelines to support the development of a third company.

Again, before INSURANCE COMPANY can make the decision to create a new company, more information is needed to know the make-up of the INSURANCE COMPANY and the INSURANCE COMPANY books of business. This will enable the management team to see if there is a segment of business that is not being serviced by either of the existing companies.

For each company, a need to review the spread of business for the following exists:

1. <u>Coverage A:</u>
   How much of the book is less than $AMOUNT, between $ AMOUNT and $ AMOUNT, between $ AMOUNT and $ AMOUNT, and over $ AMOUNT?

2. <u>Protection Class</u>:
   What part does protection class play in your current rate structure? What protection classes are rated the same? Is most of the business in one protection class? Are most of the high valued dwellings located in one protection class?

3. <u>Year of construction</u>:
   Is most of your business between 0 – 5 years old; 10 – 25 years old;
   50 - 75 years old? Is there a range of age not represented in your book? In what age bracket are most of the high valued dwellings?

4. <u>Years of renovation</u>:
   How much of the book is old enough to require updating of utilities, roof, plumbing. What is the range of Coverage A for these risks?

5. <u>Claims paid</u>:
   What value of house and/or area has the most claims? What value of house and/or area has the largest dollar amount of claims?

To state the obvious, it is much more difficult to create a third company than it is to eliminate business written in that company.

CUSTOMER SERVICE CALL LOG

Underwriter Name: ______________

Date / Time problem opened: ________________
Date / Time problem closed: ________________

Total time spent on problem/question: ____________________

Agent Name: ___________________ **Contact:** _______________

Category of call (circle one):

Homeowners Auto Dwelling Fire

Umbrella Miscellaneous

Question:

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Resolution:

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____

UNDERWRITING SELF-AUDIT CHECKLIST

Underwriter ____

Named Insured ____

Policy Numbers ____

Transaction Types Reviewed ___New Business ___Renewal
___Billing ___Endorsements

	Satisfactory	Unsatisfactory
Adherence to Underwriting Guidelines	__________	___________
Insurance-To-Value Requirements	__________	___________
Claims Review	__________	___________
Completeness of Information	__________	___________
Referral Requirements	__________	___________
File Documentation	__________	___________
Timeliness of Transactions	__________	___________
Corrective Action Taken	__________	___________
Correspondence	__________	___________
Appropriate Follow-up	__________	___________
Data Quality	__________	___________
Account Underwriting	__________	___________

Comments:
____
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____
____

Date _________________ Reviewer __________________________

UNDERWRITING SELF-AUDIT QUARTERLY RESULTS

Time period of review ___________________________________

File Grade:	Policies	%	Policies	%	Policies	%
Satisfactory						
Unsatisfactory						
• Information missing						
• Action needed						
• Not written in correct Company						
• Cancellation / non-renew risk						
• No account underwriting						
TOTAL policies reviewed						

Recommendations:

____
____
____
____
____
____

Date ___________________ Reviewer ______________________________

REUNDERWRITING CHECKLIST

Policy Number or Named Insured ____

			COMMENTS
Home insured to value	Yes	No	______________________________
Additional exposure pictured	Yes	No	______________________________
Condition of the roof acceptable	Yes	No	______________________________
Risk Acceptable	Yes	No	______________________________
Written in correct Company	Yes	No	______________________________
Action needed	Yes	No	______________________________

Comments:

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____
____

Date ____________________ Underwriter __________________________

REUNDERWRITING STATUS REPORT

Starting Date ______________________________

Line of Business ______________________________

Files Reunderwritten ______________________________

Completion Date ______________________________

	Number of Policies	% of Total Re-underwritten
No changes needed	____________	____________
Underinsured	____________	____________
Additional exposure found	____________	____________
Company change	____________	____________
More information needed	____________	____________
Do not renew	____________	____________
Cancel policy	____________	____________

Comments:

____

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Date ____________________ Reviewer __________________