PLAINTIFF'S EXHIBIT 775

MEMO

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TO: M. R. Greenberg

DATE: April 30, 1999

RE: ***Internal Audit Report #99-45***
Audit of New Hampshire Insurance Group
and AI Warranty Divisions

We completed an audit of New Hampshire Insurance Group and the AI Warranty Division. During the audit, there was a significant reorganization of the New Hampshire Divisions. Program Divisions (20 and 66) were moved to Lexington (Lexington's action plan is attached); the Middle Market Package and Small Business Divisions (24 and 22, respectively) were consolidated under new management and placed in runoff. The more significant control weaknesses identified during our audit are summarized below. Findings and recommendations related to consolidated Division 24 are addressed under separate cover to management responsible for the runoff.

Warranty Business – Division 31
Divisional management must ensure that loss accounts maintained by Third Party Administrators (TPAs) are reconciled to claims reported to the Division and that TPAs adhere to claims authorities. Procedures must be strengthened to ensure that all premiums are reported, remitted and coded timely. Promissory note balances should be adjusted for reported claims. Management must ensure that financial reviews and security calculations are performed for captives, and that security trusts are adequately funded.

Program Divisions – Divisions 20 and 66
Significant improvement is needed with respect to management's monitoring of Program Administrators (PAs). Procedures are needed to ensure that underwriting guidelines are adhered to, all policies are reported and paid, policies are issued in a timely manner and proper rating plans and forms are used. Efforts should be made to automate the processing of this business. Endorsements, cancellations and audit adjustments should be monitored and coded in a timely manner. Management must reinforce Notification of Coverage (NOC) procedures with PAs to ensure that AIGCS is properly notified of deductible clauses and other relevant information. As previously mentioned, this business has been transferred to Lexington. Lexington management has developed an action plan which includes a technology plan that will essentially automate the MGA reporting process, and should facilitate resolution of many of the recommendations. A copy of Lexington's response and action plan is included with the report.

Our review of the Ski Program administered by Willis Corroon revealed weaknesses in its controls over recovery checks, manual claims checks, and monitoring of SIRs and deductibles. AIGTS has indicated that they have notified Willis Corroon of our findings and recommendations, and will ensure compliance prospectively. Willis Corroon should also improve its premium audit tracking procedures and ensure that audits are performed and submitted to Division 20 in a timely manner.

Prior Recommendation Status
Only 10 of the 15 prior recommendation were fully or partially implemented; five were not implemented at all. The recommendations are reiterated in the body of the report. Appendix I summarizes the status of each of the prior recommendations.

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Conclusion

Although significant control weaknesses were noted, they did not result in a material misstatement of financial statements. The Lexington Management team has been responsive to our recommendations; successful implementation of the action plan will facilitate a stronger control environment. Management of the Warranty Division has also committed to effect process improvements. We have assigned a rating of 2 – satisfactory compliance in light of management's commitment to improve controls.

Keith L. Duckett

DISTRIBUTION

Lexington
N. Anselmo
D. Jordan
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J. Keogh
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70 Pine
R. Beier
J. Blumenstock
L. English
T. Formoso
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E. Greenberg
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K. Moor
M. Paffman
J. Schattin
H. Smith
T. Tizzio
J. Yu

Philadelphia
M. Bender

175 Water
K. Anantharam
M.. Castelli
C. Chamberlain
E. Kohl
K. Moor
G. Muoio
A. Ruotolo

110 William
C. Beighley
R. Frieshenhan
R. Hernandez
C. Milton
R. Ruggiano
R. Topping

80 Pine
W. Jacobi
D. Worthington

160 Water
W. Krivoshik
T. McCoy
S. Sitrin

AMERICAN INTERNATIONAL GROUP, INC.
INTERNAL AUDIT REPORT
NEW HAMPSHIRE INSURANCE &
AMERICAN INTERNATIONAL COMPANIES WARRANTY DIVISION

BACKGROUND AND SCOPE

The Internal Audit Division (IAD) recently completed the audit of the New Hampshire Insurance Group Divisions 20 (Program Division), 22 (Small Business), 66 (Management Professional Liability), Division 24 (Commercial Package) and 31 (Warranty Division). During the year, the Division 20 and 66 were reorganized under Lexington management and integrated with the Lexington Program Business. Division 24 and 22 businesses were consolidated under new management. Division 31 remained a separate Warranty division.

The purpose and scope of our review was to conclude on the accuracy of reported financial results as of June 30, 1998, evaluate the adequacy and effectiveness of the operations and control environment and follow-up on prior audit comments and recommendations. We reviewed the underwriting cycle for Divisions 20, 22, 24, 66 and 31 and the claim cycle for Divisions 20 and 31, Home Office controls over Program Administrators, reinsurance placement and processing, state and legal filings, service and compliance standards, cancellations, premium adjustments, cash receipts, receivables and operating expenses.

We also performed an underwriting and claims review of Willis Corroon and an underwriting review for North Island Facilities, Program Administrators who administer the ski resort and social service agency programs respectively for Division 20. An underwriting and claims review was performed of Division 31's VISA and Best Buy Product Warranty Programs and the Auto Warranty programs.

Our review included results based on IAD's computer based audit exception reports. The exception reports highlight variances from AIG standards for timely premium processing, cancellation processing, broker commissions, reinsurance processing, receivables and premium audits, claims processed prior to policy coding, policy number sequences utilized by various producers, etc. We also generated exception reports relating to transactions processed after the policy expiration date, endorsement processing, large losses and facultative reinsurance transactions. These reports provide increased audit coverage through a review of numerous transactions. The reports were extracted for the entire population from January through May 1998. Findings resulting from the review of these reports are incorporated within the body of this report.

We reviewed a total of 78 policies and three programs of the warranty business. The total number of files reviewed for each Division is noted below. We reviewed underwriting files effective September 1997 through May 1998 for the Divisions as noted below:

	Office		Underwriting Accounts
Division 24:	N.J.: Parsippany		32
	Boston		16
Division 20:	Home Office	(2 programs)	30
Division 31:	Home Office	(VISA, Best Buy and Auto Warranty Programs)	

This report is restricted to weaknesses noted and recommendations for improvement. It is not intended as a commentary on the favorable aspects of the New Hampshire Insurance and Warranty operations.

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Division 66

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DIVISION 31 - WARRANTY BUSINESS

Division 31 writes auto and product warranty (Brown & White) coverage exclusively through 13 Third Party Administrators (TPA's). These TPA's also adjust claims and issue claim payments. The division had $236MM in GWP through 9/30/98, $134MM (57%) was generated by auto warranty and $102MM (43%) was generated by product warranty. As of 9/30/98 the auto warranty and Brown & White books of business had combined ratios of 119% and 98% respectively.

IAD reviewed controls surrounding payment and processing procedures for all TPA's and performed detail testing for 3 TPA's: Warrantech Automotive Services Inc., Insurance Specialists, Inc. (ISI) and National Electronic Warranty (NEW).

I. CLAIM REVIEW

A. Claim Funding

Division 31 must ensure that TPA's maintain and submit proper documentation in support of claim payments. Further, management needs to review the ZBA and imprest account activities regularly to ensure that funds are adequately managed by the TPA.

Zero Balance Funds Warrantech funds are deposited daily by AIG into a zero balance account via wire transfer to cover claim payments that clear the account. There is no monthly reconciliation prepared by the TPA of the checks issued, cleared and outstanding for the month through the zero balance account to the claims submitted by the TPA to the Warranty Division. This impacts the divisions ability to tie out losses reported by the TPA to checks issued by the TPA.

Imprest Accounts DBG Comptrollers funds the imprest accounts for claims reported and paid for ISI and NEW. The amount of funding is based on the TPA's reporting of claims paid for the month. There is no monthly reconciliation prepared by the TPA of the checks issued, cleared and outstanding for the month through the imprest account to the claims submitted by the TPA to the Warranty Division. This impacts the divisions ability to tie out losses reported by the TPA to checks issued by the TPA.

RECOMMENDATION

Where AIG is directly funding the ZBA and Imprest account, a comparison between what was funded by AIG to what the TPA actually issued for the month should be performed by the TPA. Bank Reconciliations should be prepared by the TPA and reviewed by the division to ensure checks issued by the TPA agrees to the actual reported claim activity.

B. Claim Reporting

Improvement is needed in monitoring payment authority, policy limits and aggregates by Division 31. Detail claim information is not provided to New Hampshire by NEW for the Visa and Best Buy programs. In addition, NEW is reimbursed for loss adjustment expenses based on the number of credit cards issued by Visa, however NEW does not provide this information to New Hampshire. Payments for loss adjustment expenses are made to NEW without routine verification of the accuracy of the amounts.

Warrantech and ISI (Auto Warranty) have claim payment authority of $6K per claim. Claims exceeding this amount need to be referred to Home Office for approval. The claim checks require signatures from both New Hampshire and the TPA's officers when individual claims exceed these limits. Division 31 did not monitor this claim activity to ensure that claim limits were not exceeded. Management has indicated that they now review the NATS data for claim limits and sign off on all claims paid by the TPA in excess of their authority.

RECOMMENDATION

Division 31 must ensure that NEW maintains and submits proper documentation in support of claim payments and that payments do not exceed TPA's authority. Division 31 should review the NATS data regularly for Warrantech and ISI claim payments to ensure TPA's are not exceeding their claim payment authority. In addition, Division 31 needs to implement procedures to monitor policy limits and aggregates and verify the number of credit cards issued in support of loss adjustment expense reimbursement.

C. Claims Coding

Improvement is needed to ensure timely and accurate coding of claim payments. Our review revealed that Division 31 management does not review LMS to ensure that claim payments which have been submitted by NEW for reimbursement have been posted correctly for product warranty business. Our review noted that loss adjustment expenses were erroneously coded as indemnity payments on the Visa program. In addition, invoices submitted by the TPA for the Visa Program are not canceled when paid to prevent duplicate payment.

RECOMMENDATION

Division 31 needs to ensure claims are coded timely and accurately. Home Office should periodically review coding to ensure accuracy. Management should evidence their review on coding sheets. Tracking logs should be established to ensure all items are coded or properly accrued for until coded. Management should ensure paid invoices are canceled to avoid duplicate payments.

II. PROMISSORY NOTES

Promissory Note balances for Division 31 need to be adjusted in the DBG General Ledger to the extent of claims paid on the programs. Promissory notes are issued to the New Hampshire Group by AIG Warranty Services (Auto Warranty) and AIG Warranty Guard (Product Warranty-Best Buy and K-Mart programs) to clear accounts receivable balances for premiums booked. These notes are to be reduced as claims are paid on these programs. Our review indicated that for auto warranty business the promissory notes were not being reduced by the losses. As of 9/30/98, the face value of notes issued was $140MM. DBG Comptrollers indicated hat these notes would be reduced beginning in the 3rd quarter 1998. For Product Warranty, the face value of the notes was reduced for the first time in the 1st quarter of 1998 although the notes were booked as far back as 7/96. The current value of issued notes net of losses for Product Warranty is $240MM as of 9/30/98.

RECOMMENDATION

Division 31 management should coordinate with DBG Comptrollers to ensure that promissory notes are reduced as appropriate and properly reflected in the General Ledger.

III. AUTO WARRANTY

A. CAPTIVES

Control weaknesses were present in the formation and monitoring of the captives. Division 31 (Auto Warranty) has approximately 30 captive arrangements that were established through two Third Party Administrators (TPA's): Warrantech Automotive Inc. and Insurance Specialists, Inc. Approximately $11.1MM in GWP was ceded to the captives from 1/1/98 through 7/30/98. Division 31 intends to continue with the practice of allowing TPA's to establish captives. We noted the following control deficiencies to be addressed:

1. FINANCIAL REVIEW

Financial reviews of the principals that form the captive have not been performed when the captive is first established nor is there an annual financial review process in place to assess the ongoing financial strength of the captive and appropriate security needs. Beginning in January '99, Warranty management has put in place a financial review and approval process of the captives through the DBG Credit and Security Department.

RECOMMENDATION

Management should ensure that procedures for review and approval of captives are enforced and that security calculations are consistently forwarded timely to the DBG Credit and Security Department. Security should also be reviewed and approved by the AIG Credit Officer.

2. SECURITY REQUIREMENTS

a. Trust Fund Agreements and Balances

Proper measures are not taken to ensure that the security trusts are adequately funded. Our review of 5 captives Indicated deficient trust fund balances based on unearned premium reserve. Division 31 did not consistently send quarterly notices to the captives in an effort to collect the deficient balances. The trust fund agreements reviewed were obtained in 1997.

- For 2 Warrantech captives, LLH Reinsurance Company, Inc. and RBH Reinsurance Company, Inc. with deficits as of 3/31/98, it was noted that no quarterly deficiency notices were sent. These trust accounts had been deficient 8 of the 10 months since inception.
- 2 ISI captives, Prism Casualty Reinsurance and BS Enterprises had trust account deficits. Quarterly deficiency notices were sent for the first time as of December 31, 1997 although the accounts had been deficient for 9 months since inception.
- Terms of the reinsurance agreements require ISI captives, to remit to New Hampshire, in lieu of security, an interest penalty in the amount of .75% per month for each month the accounts are deficient. New Hampshire has not billed nor received this money. There was overdue interest accrued for these captives as of 3/31/98.

RECOMMENDATION

Procedures should be strengthened to ensure trust account balances are analyzed and reviewed quarterly for adequacy and those deficiencies in account balances are corrected immediately. In addition, procedures should be implemented to ensure that notices are sent on a quarterly basis to notify captives of deficient balances. Management indicated that security calculations have been prepared for Warrentech captives as of 12/31/98.

Division 31 management must ensure interest and penalties are billed and captives remit interest penalties in accordance with their reinsurance agreement. Warranty management indicated that the deficiency notices will be sent out as of 3/31/99. In cases where balances are not remitted, DBG Legal should be notified to pursue collection efforts.

b. Investment Agreements

For the 8 captives that did not have investment advisory agreements with AI Global, there was no evidence of DBG or AIG Credit Committee review or approval of the investment choices made by the captives. Our testing revealed that one of the captives invested in the Pacific Horizon Prime Fund. This fund is not on the NAIC approved fund list, and puts the TPA in violation of their security trust agreement.

RECOMMENDATION

In instances where captives do not have an investment agreement with AI Global, Management and the AIG Credit Committee should implement review and approval procedures to ensure that captives' investment choices are in accordance with the security trust agreements. Investment portfolios should comply with the NYS Insurance Law as it pertains to investments including securities of American Institutions issued by solvent American Institutions that have a rating of AAA or AA or equivalent by any of the major credit rating agencies or in money market mutual funds.

B. REINSURANCE

Because of limitations in the NAT system, Division 31 (Auto Warranty) was unable to provide to their reinsurer, Overseas Partners, Ltd. (OPL), reliable premium and claim data per the terms of the reinsurance agreement. Subsequently, the reinsurer threatened to rescind all the 5 treaties New Hampshire had in place with them. Based on a reconciliation and agreement of effective dates of the treaties, an analysis was performed by New Hampshire of actual amounts ceded to OPL compared to what should have been ceded.

The settlement required OPL to refund New Hampshire $30.2MM in over-ceded business. Within this amount were losses and earned premiums each totaling approx. $14.4MM. All settlement money has been received by AIG. Currently, all new auto warranty business is now being held 100% net to the division.

RECOMMENDATION

Division 31 should continue efforts to ensure data in the NAT system is reliable. Management should continue to reconcile premium and claim information to ensure accurate amounts are ceded to reinsurers. In addition, analysis must be performed of the capacity of auto warranty division to maintain the business on a 100% net basis.

IV. WARRANTY PRODUCT REVIEW (Brown & White)

The Warranty Division offers product warranty (computers, appliances, stereos and video equipment) through retailers. IAD reviewed premium and claim reporting and recording processes of the Best Buy and the VISA Programs. Due to the large volume of data, the detail level information is maintained by National Electronics Warranty, a TPA who also performs audits of these programs.

A. Premium Remittances (Best Buy Program)

Controls surrounding the remittances of the premium for the Performance Replacement Plan (PRP) of the Best Buy Program require strengthening. PRP premiums represent approximately $2.1MM of Best Buy's total $120MM premiums. The following was noted during our review:

- Premiums are not remitted timely by NEW for the Best Buy PRP program. Based on our review of AIGWG's mutual fund statement, we noted that premiums totaling $1.3M were remitted an average of 3 months late. It should be noted that NEWs' agreement does not stipulate payment due dates. Management indicated that the new agreements being negotiated will indicate premium remittance terms.

- Best Buy submitted premium incorrectly to NHIC due to an incorrect discount calculation. Best Buy included the PRP premium in their discount calculation resulting in an underpayment of $94K to NHIC. The Best Buy contract should indicate whether the PSP or PRP premium should be included in the discount calculation. Division 31 management is pursuing recovery of this money with Best Buy.

RECOMMENDATION

Division 31 needs to monitor premium remittance by TPA's to ensure timely receipts of monthly statements and premium receipts. Follow-up efforts should be performed if premium is not remitted on a timely basis. Management should amend the TPA agreement to stipulate premium remittance requirements. Compliance with this procedure should be monitored during the annual TPA audit.

B. Coding

1. Timeliness

Division 31 does not code premiums for the Performance Replacement Plan (PRP) portion of Best Buy and Visa Programs timely. Our testing revealed premiums totaling $1.3M for the Best Buy's Performance Replacement Plan (PRP) were coded 2 months late, 1997 premium for the Home and Extended Service Agreement (ESA) totaling $153k and $92k, respectively, was not coded until 2/98 and the second quarter premium for the VISA Extended Protection (EP), Purchase Security (PS), and ESA plans and 1998 premiums for the Home plan have not been coded as of August '98.

2. PUC Codes

Underwriting management does not allocate premiums for the EP and PS plans to proper PUC codes. Failure to allocate premiums to proper PUC codes impacts the ability to evaluate premium by program. Management indicated there is no basis for the allocation of premium to PUC codes.

3. Coding Accuracy and Management Review

Procedures surrounding the review process of premium reporting by TPA's and coding needs to be strengthened. We noted the following:

- Management review of quarterly reports received from the adjuster CBSI is not documented. As a result of an error in the Warrantech report, the 12/97 premium for the Home plan was not coded accurately. Management had not processed adjustments to correct this error as of 8/30/98.
- Management does not reconcile information received from CBSI to information coded in PPS. CBSI submits information quarterly to Division 31 detailing the number of credit cards in the Visa program. Our review of these reports indicated that the totals per the CBSI report do not agree to information coded into the system. The total allocation submitted by CBSI for the 1st quarter '98 was not coded accurately by Division 31 which resulted in premium allocations being understated.

RECOMMENDATION

Division 31 management must ensure premiums are coded to PPS in a timely and accurate manner. Quality review procedures need to be implemented and documented to ensure premium information is coded accurately in corporate record. Management should evidence their review on the Corporate Verification Report. In addition, management needs to establish a basis for allocation of premium to PUC codes. Underwriting management must perform a documented review of reports received from the TPA's. Monthly reconciliation should be performed to ensure information reported by TPA's agree to premiums coded to corporate record.

DIVISION 20 – PROGRAM BUSINESS

The Program Business of New Hampshire is coded by Home Office based on information reported by the PA's via actual policy declaration pages. Currently this division codes all policy information into PPS. Subsequent to our audit, this book of business has been transferred to Lexington in Boston. The large volume of policies, the difficulties involved in coding multi-line ISO rated policies, and delays by PA's to submit information timely have resulted in large backlogs of uncoded policies.

We also noted that currently there is no standardization of systems utilized by PA's to rate and issue policies. This impacts the ability to verify the adequacy of rate and forms updates in the different systems utilized by the PA's.

I. NHIG CODING

A. PA Reporting and Coding Backlogs

Controls surrounding the premium and bulk coding process as regards receipt of information from PA's, management of information and subsequent coding of information need strengthening.
Currently, all the PA policies are submitted manually to Division 20 by the Program Administrators. Monthly GPW includes coded premiums, uncoded premiums that are bulk coded by the division and unreported premiums that are bulk reported by the PA since the policies have not been issued or forwarded to the Division. IAD reviewed the July bulk coding backlog for Division 20 which totaled $26MM. Of this, $25MM of the bulk relates to policies reported as bound but not issued by the PA, and $1MM represents the NHIG coding backlog. This excludes balances related to uncoded and unreported endorsements. (See comment B). Weaknesses noted in the control of bulk coded information include:

- There is no reconciliation process in place to ensure that all premiums bulk coded premiums are eventually bound and issued by the PA or coded completely and accurately by NHIG.
- Physical policies are not properly controlled to ensure accuracy of bulk estimate premiums. Physical policies can be in one of three locations: in a cabinet waiting to be coded, on the underwriters' desk, or on a coder's desk. This allows for premium discrepancies and omissions in premium coding, accruals and accounting.
- Premiums effective in December '97, totaling $1.1MM (5%) of $24MM were bulk coded in July.

The large volume of uncoded premium resulted in standalone cash balances totaling $10MM in 1998. Also, processing and settlement of reinsurance premiums are impacted by these coding delays. In the absence of timely coding of policy premiums, collection efforts are dependant upon the PA submitting accounts current timely.

RECOMMENDATION

Division 20 management should verify subsequent policy issuance to PA reported items on a random basis and track uncoded premiums.. Late submission of policy declaration pages and policy issuance should be addressed with the PA to ensure appropriate action to correct. Initiatives to utilize tape to tape premium reporting should be focused on by management to automate the coding process. Physical policies should be secured in one location and logged to ensure proper accrual estimates.

B. Coding – Endorsements, Audits and Cancellations

Endorsements, audits and cancellations were not coded into the underwriting system timely. Division 20 does not monitor premium bearing endorsements, cancellations, and audit coding. Management does not have a report or tracking tool to identify uncoded/pending endorsements, audits and cancellations. Failure to code endorsements/cancellations or audits in a timely manner and may adversely impact cash flow and result in claims being paid on canceled policies or claims improperly denied for a coverage that was endorsed to a policy. Collections cannot issue cancellation notices for non-payment of premium, as policies have not been coded into the system. As a result, a true receivable position cannot be determined.

Our detail testing in Willis Corroon revealed 5 (50%) of 10 Willis Corroon transactions totaling $34k, were coded an average of 2½ months after policy expiration. Three of these transactions represent original policy premiums. In addition, Willis Corroon performs audits on a voluntary basis and obtains audit information from insureds which is forwarded to NHIG home office for coding. Our sample testing revealed premium audits totaling $115K were performed and reported to Home Office by Willis Corroon but coded into Corporate Records an average of 9 months after the final audit was received.

RECOMMENDATION

Division 20 management should ensure that all endorsements, audits and cancellations are tracked and coded timely into the system. Division 20 management must develop procedures to ensure endorsement, audit and cancellation information submitted by the PA is coded into Corporate Record. Management should perform a reconciliation to ensure all transactions on the premium transmittal are coded into Corporate Record.

II. HOME OFFICE MONITORING OF PROGRAM ADMINISTRATORS

A. Underwriter Authority

There are no controls in place to ensure that policies requiring Home Office approval have been properly referred by the PA's. Division 20 Program managers do not review policies periodically or during annual PA audits to ensure PA's are within authority. We noted instances of policies that exceeded the PA's authority that were not referred to Home Office.

During our underwriting review of NIFS, we also noted policies which included Sexual Abuse coverage where the NIFS underwriting guidelines specifically prohibit including Sexual Abuse coverage for Day Care Center and Home Health Care policies. Home Office approval was not obtained.

B. Rates and Forms

Underwriters do not consistently spot check or review policies during scheduled PA audits to ensure that forms, rating and pricing are correct. During an audit performed by the DBG Underwriting Services Group of The Insurance Professionals (TIP) it was discovered that TIP was not consistently following the filed rating plan. North Island Facilities (NIFS) was utilizing non-filed AIG rates which resulted in the NY State auditors demanding refunds totaling $245K to the insured.

RECOMMENDATION

Home Office management should generate a flag report to identify policies that require Home Office approval and ensure these policies have been referred for approval. In addition, underwriters should scan the weekly premium transmittals to determine if any policies were issued in excess of the PA's authority level and request those policies from the PA. In order to ensure that PA's utilize filed rates, underwriters must consistently spot-check policies submitted to NHIG for coding and review adherence to rating plans during annual audits.

C. Complete Reporting Of Premiums

Division 20 Home Office management does not review policy registers to ensure that all policy numbers are reported and premiums are received. Unutilized policy numbers are not confirmed periodically or during PA audits to determine whether items are voided or need to be reported and paid. IAD analyzed the policy registers and noted policy numbers indicated as spoiled during 1996-97 were actually issued by PA's. We also noted that gaps in policy sequences are not monitored or researched by Division 20 management. PA's are issuing policy numbers that were allocated to other PA's that were not in their allocated policy number range.

RECOMMENDATION

Division 20 needs to ensure that all policy numbers have been properly accounted for randomly during the year and during the annual PA audits. Management should consider developing a report to identify policy numbers that have not been accounted for as well as usage of policy numbers that were not assigned to PA's. In addition, underwriters should scan the weekly premium transmittals to determine if any policies were issued in excess of the PA's authority level and request those policies from the PA. In order to ensure that PA's utilize filed rates, underwriters must consistently spot-check policies submitted to NHIG for coding and review adherence to rating plans during annual audits.

D. Policy Issuance

As noted in our prior audit report, efforts are needed by Division 20 to enforce policy issuance standards with PA's. PA's consistently do not issue policies timely to insureds. Currently, there are no procedures in place by Division 20 management to ensure that the PA complies with our policy issuance standard. Our testing revealed that PA's remit policies an average of 3 months after the policy effective date. This impacts timely detail coding and collections of premium as noted in comment A. Adherence to policy issuance standards is not reviewed during annual PA audits. This has been commented on as a part of the DBG Underwriting Services Group audit. Underwriting /Operations must also review and document the reasons and actions for Program Administrator backlog for bound but unissued policies.

RECOMMENDATION

Division 20 Home Office management should develop procedures to ensure PA's comply with policy issuance standards. Underwriters should review weekly premium transmittals and bulk coding to determine if policies are being issued late. Policy issuance standards should also be reviewed during annual PA audits. In addition, Home Office should consider developing PA tapes that monitor policy aging and quality control for late issued policies. PA's that fail to issue policies timely should be evaluated to determine appropriate action and continued use.

III. WILLIS CORROON SKI PROGRAM

IAD reviewed the underwriting and claims procedures performed by Willis Corroon, a Program Administrator (PA) which administers the ski business for Division 20. Willis Corroon wrote gross premium written of $12.8M during 1997 and $8.5M as of 9/98. Willis Corroon forwards premium data manually to Division 20 for coding to PPS. Willis Corroon accesses LMS and processes ski claims and payments directly into LMS. Claims are monitored / managed by AIGTS processing.

A. CLAIMS OPERATIONS

1. Cash Receipt Controls

Procedures and controls over processing recovery checks need strengthening. There was no evidence that Div. 20 or AIGTS had notified Willis Corroon of these corporate procedures, nor has a review of check receipt controls been performed by Div. 20 or AIGTS. Willis Corroons has an E&O policy for $5MM. Our review identified the following control deficiencies:

- There is a lack of segregation of duties over the cash receipts function in Willis Corroon. One person has responsibility over receiving, recording in the recovery log, and preparing the recovery transmittals for the Cash Receipt unit.
- Checks are not logged and restrictively endorsed upon receipt. Checks are logged in the recovery log and endorsed at the end of the week when checks are sent to A.I. Recovery.
- Willis Corroon does not forward recovery checks within 24 hours. In addition, daily check receipts totaling $10,000 or more are not forwarded to A. I. Recovery via overnight mail as per AIG procedures.

- Willis Corroon does not review the required sample (10% per month) of recovery c ecks received to ensure the checks were receive and accurately entered on the claims system by A. I. Recovery.
- Willis Corroon receives checks noted "Full & Final Payment" and does not review these checks to ensure they are actually full and final payments. They are forwarded to A.I. Recovery along with other recovery checks

RECOMMENDATION

AIGTS / Div. 20 management should ensure that the following procedures are implemented to strengthen controls surrounding the ash receipts process:

- Check receiving and recording functions should be segregated. Checks should be immediately logged and restrictively endorsed upon receipt. The cash receipt and check transmittal logs should be periodically reconciled by an independent person to ensure completeness of deposits.
- All Recovery c ecks received s ould be forwarded to A.I. Recovery within 24 hours. Any rece pts greater than $10K individually or in a daily cumulative amount should be sent to A.I. Recovery via overnight mail. A periodic review of 10% of checks received and forwarded to A.I. Recovery s ould be performed to ensure timely and accurate posting of payments to the claims system.
- Checks noted "Full & Final Payment" should be reviewed to ensure that all these checks are for the full amount that is due. If not, they should be voided and returned to t e sender.
- Div. 20 management should reiterate cash receipt procedure and periodically reivew adherence.

These procedures should be instituted and reviewed in all Claims offices where Willis Corroon adjusts Div 20 Ski program claims.

2. **CASH DISBURSEMENTS**

Controls over cash disbursements need to be strengthened. T e following cont ol weaknesses were ident fied:

- Surp ise inspections of unused manual checks are not documented by Willis Corroon and such review is not performed by AIGTS as part of the annual claims audit. This comment was noted in our prior audit. We reviewed the AIG manual draft inventories held by Willis Corroon and concluded that all manual draft inventories were properly secured and accounted for.
- Authorization for issuing manual drafts are not consistently documented in claim file. Willis Corroon management indicated that such authorizations, in some cases, were verbal.
- Willis Corroon management does not review the Manual C eck/Draft Register (5 randomly selected drafts per week as per procedure) to ensure selected drafts are alid and posted to the system. Management indicated they were not aware of this procedure.

RECOMMENDATION

AIGTS and Division 20 should ensure that proper authorization for issuing manual drafts are documented in the claim file; surprise inspections of unused manual checks should be performed and documented by Willis Corroon and all checks should be accounted for when annual review is performed by AIGTS or Div. 20. In addition, AIGTS should ensure that Willis Corroon is aware of procedures surrounding cash disbursements and adherence to such procedures.

3. **ADJUSTER LICENSING**

AIGTS should ensure Willis Corroon adjusters are properly licensed in states where they adjust claims. We noted that Willis Corroon adjusters are licensed to adjust claims in New Hampshire, Maine, Vermont and Utah. However, Willis Corroon is adjusting claims in 24 other states. IAD could not ascertain if

Willis Corroon ensured that adjusters are properly licensed in 11 states where licensing is mandatory. (Adjusters are not required to be licensed in the other 13 states).

RECOMMENDATION

Division 20 Home Office and AIGTS should ensure adjusters are properly licensed and incorporate this as part of the annual audit.

4. CLAIMS AUTHORITY

Improvement is needed to ensure payment authority for terminated employees is forwarded and removed to DBG ISG timely. Requests to delete LMS reserve and payment authority for 2 claim assistants no longer employed by Willis Corroon were not forwarded to the GTAM / ISG department timely. Based on IAD's review, these employees left the company in 3/95 and 1/97 respectively. Requests to delete the authority were forwarded on 6/98.

Willis Corroon indicated that requests to delete the above employee might have been forwarded to the GTAM department when the employee left the company. However, there was no evidence documented on file to support that GTAM department was informed of the changes.

RECOMMENDATION

AIGTS and Div. 20 should ensure the GTAM / ISG department is informed of the authority changes (i.e. new and or terminated employee) timely during their annual review. Any requests for such changes should be documented on file. Periodic reconciliation should be completed by AIGTS based on authority listings from ISG.

B. DEDUCTIBLES AND SIRS

1. Outstanding Deductibles balances

As noted in our prior report, improvement is needed in the collection and monitoring of outstanding deductible and SIR balances. Division 20 and AIGTS do not monitor the collection of outstanding deductibles and SIR's performed by Willis Corroon.

- As of our testing date, $350K in deductibles were outstanding over 90 days. These cases are handled directly by Willis Corroon's New Hampshire office. IAD noted that documented follow-up efforts by Willis Corroon to recover outstanding deductibles were not evidenced in the claim files.
- There is no monitoring report maintained by Willis Corroon to identify and track outstanding SIR payments due to NHIG.
- For the 2 SIR files reviewed with SIR's, claims totaling $16K have not been recovered and A. I. Recovery had not been notified.
- Willis Corroon needs to improve administration of accounts with SIRs and Deductibles recovered. SIRs and Deductibles totaling $6,700 were not coded in LMS overstating losses.

RECOMMENDATION

Division 20 should review and monitor the outstanding deductible report on a monthly basis to ensure timely collection of deductibles by Willis Corroon. Over 90 day balances should be addressed immediately with Willis Corroon. During the annual claims audit process, AIGTS should ensure Willis Corroon adjusters perform consistent follow-up to collect outstanding deductibles from insureds. All follow up efforts should be documented. Willis Corroon should institute tracking report to identify and monitor outstanding SIR's. Management should ensure deductibles and SIRs are recorded in LMS and fully recovered from insured on a timely manner.

C. LMS SECURITY REPORTS

As noted in our prior report, improvement is needed in the review of LMS security reports. LMS security reports are generated to highlight potential erroneous or fraudulent payments. We noted that Willis Corroon management does not verify transactions from the Duplicate Payment report and Claimant Name Not Equal to Payee report to claim file documents.

RECOMMENDATION

Willis Corroon management should review and validate the required sampling of claim payments processed to support in the claim file. This review should be documented. AIGTS / Div. 20 management should ensure that procedures are adhered to when annual audit is performed.

D. CLAIM FILE TESTING

IAD reviewed a total of 48 claim files with payment and or reserve transactions during July 1997 through March 1998 and noted the following:

- Controls should be strengthened to ensure reserve transactions are supported by claim file information. Documentation did not always exist in the claim file to support indemnity and legal reserve transactions.

- Willis Corroon should establish initial r serves within 15 days of receipt. We noted that there were 4 instances which initial reserves were not opened within 15 days. In addition, there were 2 instances our testing revealed where r serve changes were not made within 30 days of final payment.

- Control over the coding of claim information into LMS by Willis Corroon needs strengthening. Information pertaining to transaction codes, loss type, accident date, AIA codes, loss receipt and report dates were not accurately cod d into LMS on numerous files reviewed.

- Willis Corroon adjusters do not consistently process claim payments in a timely manner. All claim payments should be made within 2 days from the request for payment. Our review indicated that in 2 instances claims were paid on an average of 22 days and in one instance the requested day for payment was not evident. As a result, IAD cannot determine whether the payment was issued timely.

- As noted in our prior report, the Willis Corroon office located in New Hampshire does not maintain supporting documentation for expenses i curred by the Salt Lake City claim adjusters. The Salt Lake City claim adjusters complete expense reports and submit them to claims management in the New Hampshire office for payment processing without appropriate support attached.

RECOMMENDATION

The following recommendations should be implemented to improve the overall quality of the claim process:

- The adjuster's rationale for all reserve changes should be clearly documented and supported based on information affecting the case. All case reserves should be reviewed by the adjusters at periodic intervals to ensure accurate and timely coding of reserves into LMS and that reserve changes are documented.

- Management should emphasize to adjusters that initial reserves be established timely within current standards and subsequent reserves not be changed shortly before settlement in situations where the settlement amount is predetermined.
- A quality review process should be instituted to ensure that all claim information is accurately coded into LMS and applicable high cost memos are prepared and forwarded to AIGTS for approval.

- The New Hampshire claims management must ensure that supporting documentation is forwarded and maintained in the claims file for adjusting expenses incurred by the Salt Lake City claim adjusters. AIGTS should e sure compliance with this procedure during the annual audit.

E. UNDERWRITING REVIEW

Our review of Willis Corroon underwriting revealed Div 20 does not adequately review Program Administrator adherence tounderwriting guidelines. The following weakness were noted:

- Willis Corroon does not have base rate criteria established for writing auto policies. IAD was unable to verify proper use of rates in absence of a rating system. In addition, there is currently no rating system /underwrit ng system available for auto policy rating.

- Improvement is needed by Willis Corroon to ensure policies are bound by the effective date and bound terms are clearly documented in the underwriting file.

- As noted in our prior report, Willis Corroon underwriting guidelines do not outline when financial information (i.e. D&B reports, financial statements) is required from insureds. Our review revealed that financial information is not obtained by Willis Corroon on any account.

- Underwriter checklists and manager reviews are not periodically performed and documented in the underwriting files. In addition, Division 20 Home Office management does not consistently perform and document a quality review of policies submitted by Willis Corroon.

- Willis Corroon does not consistently issue policies within 30 days of policy effective date. Our testing revealed policies are issued an average of 45 days after policy effective date. In addition, there is no facility to monitor policy issuance. Management indicated they are currently establishing a task force that will improve policy issuance timeliness.

RECOMMENDATION

Division 20 management should:

- Establish and file rating criteria and consider implementing a system that will provide Willis Corroon underwriters with rate guidelines to be utilized for auto policy rating. Home Office should review compliance with established rates during the quality review and audit process.

- Ensure policies are bound in writing prior to the effective date and final bound terms are clearly documented in the underwriting file. If policies are bound subsequent to the effective date a letter of "no known losses" must be obtained from the broker.

- Establish procedures for when financial information should be reviewed and analyzed by underwriters in order to properly influence the underwriting decisions. Management should ensure underwriting guidelines specify financial information requirements. Underwriters should be properly trained to review and analyze D&B reports, which is a prerequisite to performing risk assessment of accounts. Underwriting files should be properly documented with analysis of results and/or reasons for waivers.

- Division 20 Home Office management must establish procedures that require Willis Corroon management to review and sign-off on policies prior to issuance. Upon receipt of policy information and during the annual audit, Home Office must perform quality review procedures to ensure compliance with the review process.

- Division 20 Home Office management should reinforce the importance of issuing policies timely in order to provide quality service to clients. Management should consider developing a mechanism to monitor compliance with policy issuance standards. Willis Corroon should monitor results and take appropriate steps to improve compliance.

F. PREMIUM AUDIT MONITORING

Premium audit information is being forwarded from Willis Corroon an average of 6 months after policy expiration. Willis Corroon management does not follow up on a timely basis to obtain audit information. In addition, Division 20 has not established premium audit guidelines for physical audits. During our review, Div. 20 management has developed audit guidelines for the Ski program.

Our review of the Willis Corroon premium audit-tracking log indicated that the log is not updated to reflect the audit status. IAD noted premium audits were finalized and the status was not updated on the premium audit-tracking log. Management indicated they update the log on a quarterly basis. Our review also indicated several audit transactions were not coded into Corporate Record as of our testing date.

RECOMMENDATION

Division 20 needs to develop and document premium audit procedures to be followed by Willis Corroon. In addition, the audit-tracking log maintained by Willis Corroon needs to be updated on a timely basis. Willis Corroon management should ensure required audits are performed timely and the audit-tracking log is appropriately updated to reflect the status of each audit. Also, follow up procedures should be performed to ensure audit information is received within 90 days of policy expiration. Home Office should ensure compliance with this procedure during annual reviews and through review of the premium audit-tracking log. A quality review should be performed to ensure audit transactions are coded timely into Corporate Record.

IV. NORTH ISLAND FACILITIES (NIF)-SOCIAL SERVICES PROGRAM

IAD performed an underwriting review of the NIF New York office in conjunction with the Division 20 Program manager. NIFS is a Division 20 Program Administrator that writes policies for Social Service programs. In 1997, NIF had approximately $15.6M in gross written premium which represents 16% of the book of business for NHIG. Subsequent to our review NIFS has non-renewed the Social Service Program with Division 20 due to lack of automation initiatives by NHIG. The recommendations continue to be relevant to the majority of the PA business in this division. Div 20 does not adequately monitor and program administrators and following weakness were noted:

- Neither NIFS nor Division 20 complete Notification of Coverage Forms (NOC) to be submitted to AIGCS notifying them of deductible information pertinent to NIF policies. Documentation does not exist in the policy file to indicate AIGCS was notified of the claim. Almost all the NIFS policies have deductible clauses that require notification. Currently, the NIFS Program Guideline does not discuss NOC procedures. Failure to complete NOC forms accurately may result in improper claims handling.

- Division 20 does not review premium rating for NIFS policies. NIFS underwriting files do not always contain adequate support for scheduled debits and credits. Our review revealed several files with undocumented or unsubstantiated pricing methodology. The rationale for using rates outside of the suggested rate ranges was not always clearly documented. In several instances, we noted that NIFS rating through the Scottsdale Arizona Rating System indicated that the underwriter overrode the base rate. Loss history information was not consistently obtained by NIFS. Management requires that 3-5 years of loss histories should be obtained on renewal policies.

- NIFS does not forward premium financing information to Division 20 Home Office as per the PA agreement requirements. NIFS utilizes outside financing companies for premium financed policies. Failure to notify Division 20 of financing arrangements will cause delays in cancellation notices being sent by the Collection Department to premium finance company.

- Loss control services is not requested by NIFS on a timely basis. Follow up on loss control recommendations is not consistently performed in accordance to the PA guidelines.

RECOMMENDATION

- Division 20 management must include NOC procedures in the underwriting guidelines, reinforce and monitor the proper completion of Notification of Coverage (NOC's) forms during the audit process. In addition, PA's underwriting files should indicate the that NOC's have been completed and submitted to AIGCS to ensure proper claims handling.

- PA's must ensure that premium rating and development is clearly documented in the underwriting file to support the final premium charged. Underwriters should document the reasons for granting rate modifications in cases where debits and credits are applied. Home Office should perform a review of rating during the audit process and during annual audit to ensure compliance.

- Division 20 must ensure that PA obtains the required 3-5 years of loss information to properly assess the risk prior to binding. Compliance with this procedure must be reviewed during the audit process. Underwriting files should document the review of loss information in the underwriting files.

- PA's need to inform Home Office management of policies that are financed by outside premium financing sources. Home Office should ensure compliance with this procedure during the audit process.

- PA's must ensure loss control surveys are requested for required accounts. Loss control surveys should be requested within 14 days of the policy effective date to allow sufficient time to complete the request. In cases where the loss control is being waived, reasons for waiving loss control should be documented in the underwriting file.

RISK PURCHASING GROUPS

Division 66 utilizes 5 Risk Purchasing Groups to place Miscellaneous Professional Liability business, which totaled approximately $8.4MM as of 6/30/98. Program Administrators (PA's) administer all 5 programs. Division 24 (Marine) in Boston wrote approximately $350K in General Liability coverage as of 6/30/98 for an RPG, the C-Port Program.

A. Agency Agreement

New Hampshire does not have a PA agreement with Starkweather & Shepley, the PA responsible for administering Division 24's C-Port program. Starkweather & Shepley is directly responsible for underwriting, binding and maintaining underwriting files.

B. Rates, Forms and State Filings

Procedures surrounding the filing of policy rates and forms for Risk Purchasing Groups need to be strengthened. Policy rates and forms have not been filed with the applicable State Insurance Departments for Division 66's American Club Services RPG. In addition, Division 24's C-Port program was not filed as a Risk Purchase Group.

C. Authorization and Monitoring

For one Division 66 RPG (the American Collectors Association) and the Division 24 RPG (C-Port), the Senior Management Acceptance Sign-off Sheet was not completed. Approximately $1.0MM was written through these programs through 6/30/98. In addition, a financial or underwriting audit has not been performed on Starkweather & Shepley.

Profit Center management should notify DBG Legal of all Risk Purchasing Groups and ensure that they are included on the DBG master list of Risk Purchasing Groups. During the review of Division 24, IAD became aware of the C-Port Risk Purchasing Group. This RPG was not on the DBG Master list and there is no agreement (See A.).

D. Coding

Premium coding and billing for the C-port program was not timely. IAD noted that the March, April, and May 1998 premium reported by the PA via monthly bordereau was submitted to the Service Center on 6/30/98 without priority instruction and was not coded until 8/4/98. As a result, net premium totaling $98K was billed an average of four months from the effective dates of the endorsements. The insured remitted the premium timely based on the bill date.

E. Coverage

The C-Port program provides coverage to insureds that extends beyond the effective period of the master policy. Insureds that are added to the master policy mid-term are granted coverage for a full year from the date they are added. This coverage may extend outside the effective period of the master policy. Management indicated that if the master policy does not renew, cancellation notices would be sent to those insureds whose coverage extends beyond the master policy. Management maintains a log of insureds and updates it on a quarterly basis.

<u>RECOMMENDATION</u>

- Division 66 and 24 management must ensure the Senior Management Acceptance Sign-off Sheet is completed and signed prior to conducting business with Risk Purchasing Groups.
- Management should ensure that appropriate forms and filing requirements are completed.
- Division 24 management needs to execute an agreement with Starkweather and Shepley in order to ensure that proper control is maintained with regard to the broker's underwriting practices and remittance of premiums.
- Management must follow up to obtain monthly bordereau timely and ensure that work to be processed by the Service Center is submitted on a timely basis to allow for the prompt recording and billing of premium.
- Divisional management, DBG Compliance and Corporate Legal must coordinate to ensure all are aware of each RPG to allow for proper monitoring and handling and to ensure proper audits are being performed regularly.
- Policy wording should be enhanced to include policies that do not fall within the Master Policy term.

DIVISION 66

PROGRAM ADMINISTRATORS

Division 66 had 10 active programs with GPW totaling $18.5MM through 6/30/98. 7 of these programs transferred to New Hampshire from National Union. 3 programs were recently written by New Hampshire. 2 Program Administrators that were active during the prior audit of National Union were terminated in early 1998. IAD reviewed proper PA termination procedures for these PA's. Our review revealed the following weaknesses, some of which had been identified during the 1996 National Union audit.

A. TERMINATION PROCEDURES

A final underwriting and financial audit was not performed for the 2 terminated Program Administrators – The Costanza Agency and Henry Ward Johnson. Final audits are necessary to determine outstanding receivable balances, resolve all account discrepancies, obtain copies of complete underwriting files (including risks bound, but policies not yet issued), obtain lists of all sub-producers, ensure non-renewal notices are sent, and account for and retrieve all unused AIG policy stock and supplies. Additionally, there was no evidence that the various AIG departments including the Comptrollers Division, Premium Collection Department, and Claims Department were notified that the PA's were terminated.

B. PROGRAM ADMINISTRATOR AGREEMENTS, UNDERWRITING AUDITS, E&O LIMITS

Although New Hampshire maintains a log to track the PA's E&O and Fidelity bond limits as well as scheduling of underwriting and financial audits, they do not follow-up to ensure receipt and completion of these items. In addition, the log does not provide for the tracking of the receipt of program administrator agreements. Our review disclosed the following:

- 1 of the 10 active PA's (AON Group) did not have a signed PA agreement.
- 2 agreements (Marine Agency and Albert Wohlers) were signed approximately 2 months and 7 months after the effective date of the contract.
- For 2 of the 10 active PA's (Atlantic Underwriters and Worldwide Facilities), there was no evidence that an underwriting audit has been performed. In addition, financial audits were last performed for Worldwide Facilities and Universal Insurance Facilities in November 1993 and July, 1996 respectively.
- For 4 PA's, adequate E&O limits were not being maintained. Corporate policy requires that E&O limits of $5MM and Fidelity limits of $500K be maintained.

C. POLICY NUMBER ISSUANCE AND MONITORING

Controls over policy number issuance and monitoring need to be implemented. IAD noted the following control weaknesses:

- Assigned policy numbers are not reconciled with policies transmitted from the PA nor is there a report utilized to ensure all premiums are reported and paid by the PA's. IAD noted gaps in policy numbers reported.

- Subsequent policy number block requests from the PA are not validated to the current inventory to determine if the need is reasonable and that all previous numbers have been reported and paid.

RECOMMENDATION

- Division 66 should notify all concerned parties in writing that a PA was terminated and request that final financial audits be performed as well as perform final underwriting audits to ensure all outstanding issues are resolved and all premiums reported and collected.

- New Hampshire management should consistently follow up to ensure the timely receipt of signed PA agreements and to ensure that the proper E&O coverage is maintained. An audit schedule must be maintained by an individual in the Division to ensure that annual underwriting audits are performed and underwriting deficiencies are highlighted and monitored.

- Timely remittances by PA's should be emphasized by Profit Center management through review of Account Currents.

- New Hampshire should implement procedures to monitor the issuance of policy numbers. Gaps in policy numbers reported should be investigated immediately and follow-up documented to ensure all premiums are reported and paid. In addition, management should ensure that all subsequent PA requests are reasonable based on the amount of business the PA has submitted to New Hampshire.

TREATY REINSURANCE PLACEMENT

IAD reviewed the treaty placement procedures for 8 NHIG treaties with 1997 effective dates.

A. Receipt of Placement Slips and Cover Notes

The Reinsurance Services Department should ensure that the Reinsurance Placement Report is utilized to adequately track the various stages of treaty placement and finalization to allow for efficient follow-up of documentation. 4 of 10 placement slips and/or cover notes from 8 treaties reviewed were not received as of IAD's review date and were outstanding for 18 months from the treaty effective date.

B. Standard Clauses

Evidence of a review by the reinsurance underwriter of the standard preferred AIG clauses omitted from a treaty abstract is not documented in the treaty file. A memo is sent to the divisional reinsurance underwriter by Reinsurance Services identifying clauses that are not included in the treaty abstract. The reinsurance underwriter must make a determination as to whether or not these clauses should be included in the final contract wording, however there is no evidence that this review is performed. Final contract wording may be deficient in scope where this review is not performed.

RECOMMENDATION

The Reinsurance Services Department has recently implemented the use of a database, which allows for compiling key dates and information with regard to the treaty placement process including the date of receipt of cover notes, placement slips and contract wordings. RSD is in the process of developing reports from the database, which will for allow for reviewing the status of treaties and to ensure that appropriate follow-up is performed. RSD should obtain all outstanding placement slips and cover notes.

In addition, there must be a review of the contract wording to ensure that all standard preferred AIG clauses are included in the contract. The Reinsurance underwriter should initial the clause memo as evidence of review.

TRAVEL AND ENTERTAINMENT EXPENSES

Controls surrounding the processing and approval of Travel & Entertainment expense reports and disbursement vouchers need strengthening. We noted that Expense reports and disbursement vouchers are not submitted in accordance with AIG Corporate Policy.

The following was noted during our review:

- NHIG does not consistently utilize AIG Corporate Purchasing for electronic and office supply purchases. We noted purchases totaling $5.2K in which employees used their personal credit cards to acquire electronic equipment and office supplies for NHIG. Management indicated these purchases occurred under prior management with the approval of a senior executive

- The senior executive did not consistently complete travel authorization forms for hotel and air reservations prior to trip departures and Travel and Entertainment expenses totaling $3.9k for airline tickets, hotel, meals and local transportation were approved and reimbursed with no supporting documentation. Current management has since enforced corporate procedures regarding these expenditures.

- The senior person attending the business meal does not consistently charge T&E expenses. In addition, an expense report indicated an employee as a business guest however this employee also approved the expense report for payment. Management indicated that an independent senior person approved the expense account and that the procedures are currently being reinforced.

RECOMMENDATION

- All purchases of office supplies, computer hardware and related operating software must be executed through a purchase order. Failure to use AIG Corporate Purchasing for these purchases may result in loss of AIG corporate discounts.

- Management should ensure expense reports include required information and supporting documentation and are submitted in accordance with corporate policy. Approved travel authorizations forms should be obtained before making any travel arrangements. A copy of the travel authorization should be attached to the expense reports when submitted for payment.
- When employees from the same division are dining together, the senior member must always pick up the check. In situations where circumstances make it inappropriate for the senior member to handle payment, the expense report of the subordinate must be submitted to the senior member's manager for approval.

DIVISION 24 – MIDDLE MARKET PACKAGE POLICIES

As of our report date, Division 24 business has been consolidated to 6 branches. The Marine and the Employers Professional Liability Accounts have been transferred to other AIG Divisions. The remaining accounts will be quoted for renewal by other AIG Divisions.

IAD's review of Division 24's underwriting process was focused on the New Jersey and Boston regional offices. These offices had gross written premiums of $22MM and $7.6MM, respectively through 9/30/98.

Our recommendations for Division 24 in the report have been limited to the renewed lines.

I. UNDERWRITING DOCUMENTATION

A. PRICING METHODOLOGY

For Boston DMO policies, the rationale for using rates outside of the suggested rates outlined in the Marine Underwriting Manual were not always clearly documented.

RECOMMENDATION

For DMO policies management must ensure that premium rating and development is clearly evident in the underwriting file to support the final premium charged.

B. NOTIFICATION OF COVERAGE

The Boston office does not consistently include SIR and deductible information on the Notification of Coverage (NOC) forms. NOC forms are utilized by AIGCS to verify policy coverage when claims are received. In some instances, there was no evidence to support whether the original NOC was submitted to AIGCS. Failure to complete NOC forms accurately may result in improper claims handling.

RECOMMENDATION

Management must reinforce and monitor the proper completion of notification forms through the self-audit process.

C. ENDORSEMENTS

For the Boston's Dealer Marine Operator (DMO) policies, we noted several instances of forms and/or endorsements being listed on the policy declaration page that were not attached to the policy. We also noted endorsements attached to the policies that were not included on the declaration page.

RECOMMENDATION

During the quality review process the offices should also ensure all endorsements are reflected on the form schedule of the policy and all subsequently issued endorsements are numbered and dated. Management should ensure that approval of manuscript endorsements is clearly documented in the file.

D. FINANCIAL ANALYSIS

Procedures should be strengthened to ensure current financial information is obtained and reviewed for all accounts for the Boston (Marine policies) region in accordance with underwriting guidelines. Our review revealed that a majority of the files did not include a financial analysis.

RECOMMENDATION

For the Boston Marine accounts, the new management should reinforce procedures to ensure financial information is reviewed and analyzed by underwriters in order to properly influence the underwriting decisions.

APPENDIX I
SUMMARY OF PRIOR AUDIT RECOMMENDATIONS Report #96-34

Prior Recommendation	Status
Division 20	
1. Claim payment and settlement authority of Willis Corroon must be approved and documented by division 20 management in the current MGA contract. Controls must ensure that the LMS GTAM table properly reflects the approved authority levels. Division 20 must ensure authority levels within LMS for terminated employees are deleted by the GTAM department immediately upon receipt of notification from Willis Corroon.	**Partially Implemented** See Division 20 Comment III A4.
2. AIGTS must monitor the LMS security reports on a monthly basis and the error reports weekly. Questionable items on these reports should be researched and discussed with Willis Corroon claims management and Division 20. The items selected for investigation should be documented by AIGTS. If necessary, appropriate training should be provided to Willis Corroon. All reports should be signed as evidence of review and maintained for one full year. Claims audits performed by AIGTS should verify adherence to established procedures. Division 20 should be notified of all violations and appropriate action taken.	**Partially Implemented** See Division 20 Comment III C.
3. Division 20 should review and monitor the outstanding deductible report on a monthly basis to ensure timely collection of deductibles by Willis Corroon. Over 90 day balances should be addressed immediately with Willis Corroon. During the annual claims audit process, AIGTS should ensure Willis Corroon adjusters perform consistent follow-up to collect outstanding deductibles from insureds. All follow-up efforts should be documented within the claim files. Unsuccessful collection attempts should be referred to AI Recovery for legal collection. Willis Corroon should receive confirmation from AI Recovery for all referred cases. Adherence to this procedure should also be monitored during AIGTS's annual audits of Willis Corroon.	**Not Implemented** See Division 20 Comment III B
4. AIGTS approval is required on loss adjusting expenses exceeding $1,000 prior to Willis Corroon processing in LMS and copies of all adjusting expenses should be sent to AIGTS. AIGTS should ensure adherence through review of the LMS generated check release report. AIGTS management should randomly review payments under $1,000. Willis Corroon must ensure that adjuster travel expenses are accurately coded as adjusting expenses in LMS. In addition, the Willis Corroon claims manager should not process payments to himself.	**Partially Implemented** See Division 20 Comment III B

These payments should be processed by the administrative assistant or by AIGTS if the administrative assistant is not available.	
5. Adequate legal reserves should be maintained on LMS for legal payments expected to be processed subsequent to indemnity settlement. Cases. sh uld be closed on LMS subsequent to processing the final legal expenses.	**Implemented**
6. AIGTS must perform and document an inventory of all manual drafts issued to Willis C rroon and ensure Willis Corroon adju ters are properly removed from the authorized draft signatory listing maintained by the Draft Services Department as part of it's annual claims review. Division 20 should be notified of any concerns and appropriate action taken.	**Partially Implemented** See Division 20 Comment IIIA2
7. Division 20 must establish formal procedures regarding the performance of financial reviews of insureds prior to binding coverage. Division 20 should consider having Willis Corroon perform financial ratios for all insureds and compare results to industry averages. Insureds with ratio results lower than industry averages and accounts with large self-insured re ention's or deductibles s ould be mandatory referral to division 20 for approval prior to binding.	**Not Implemented** See Division 20 Comment IIIE
8. Division 20 management and the Reinsurance Service Officer should re-enforce and monitor the completeness and accuracy of treaty coding through review of the monthly gross to net reinsurance report and the self-audit process. All incorrect cessions should be corrected and training should be provided as necessary. Management must ensure treaty abstracts provided to the Reinsurance Services Department correctly list all applicable lines of business to be covered by the treaties.	**Implemented**
9. Divisi n 20 management should continue with its current efforts to finalize contracts for the NIF program. A tracking log of the contract status for all programs should be maintained and monitored to ensure consistent efforts are performed until contracts are executed for all programs. All follow-up efforts to finalize outstanding contracts should be noted on the tracking log.	**Implemented**
10. Division 20 must ensure documentation is maintained to support all audit transactions. Division 20 management needs to implement a quality review function to ensure premium audits are coded accurately. Division 20 management should coordinate with the Premium Audit	**Not Implemented** See Division 20 Comment I A & III F

Division to reevaluate which policies are auditable and ensure that these policies are accurately coded, identified through the exclusion matrix and fed to PATS.	
11. Division 20 management needs to ensure the MGAs forward policy information, notices of cancellation and premium bearing endorsements to Home Office in a timely manner (based upon MGA contract terms). Timely remittance must be re-enforced to the MGAs and monitored during the audit process.	**Not Implemented** See Division 20 Comment I B
DIVISION 31	
1. Division 31 must continue to coordinate with DBG Comptrollers to ensure the accurate machine booking of premiums, claims, service fees, and reinsurance transactions for all warranty and credit business written to date. Going forward, Division 31 must ensure all business is machine coded accurately and timely and claims bordereau are sent to AIGTS Claims Administration monthly for proper recording of all losses and establishment of applicable reinsurance recoverables.	**Not Implemented** See Division 31 Comment IC & IV B
2. Division 31 management needs to implement a tracking mechanism to monitor the timely execution of all agency and third party administrator agreements. Division 31 must execute an agreement with CBSI and NEW outlining all required procedures including applicable premium remittance, claims processing and commission terms.	**Implemented**
3. On a monthly basis, division 16 should obtain a listing of all certificates issued and ensure treaty reinsurance is appropriately coded based upon each certificate effective date. Division 16 management and the Reinsurance Service Officer should re-enforce and monitor the completeness and accuracy of treaty coding through review of the monthly gross to net reinsurance report and the self-audit process. All incorrect cessions should be corrected and training should be provided as necessary.	**Partially Implemented** See Division 31, Comment IIIB
4. NHIG's reinsurance officer should perform an inventory to account for all required reinsurance documents. The documents on hand should be properly filed and outstanding treaty documents should be identified and recorded in a log for monitoring purposes. Every effort should be made to follow-up with the reinsurers and brokers for outstanding reinsurance documents and maintain documented support of these efforts in order to comply with the potential FASB 113 ruling.	**Partially Implemented** See Reinsurance Placement Comment A