

**Department of Insurance:
The Management of Conserved
Insurers Has Improved, but
Problems With Liquidation and
Administration Continue**

April 1996
94118

Blank page inserted for reproduction purposes only.

Table of Contents

<i>Summary</i>	S-1
-----------------------	------------

<i>Introduction</i>	1
----------------------------	----------

Chapter 1

The CLO Has Developed Plans for Conserved Insurers but Has Achieved Only Limited Success in Liquidating Them	9
--	---

<i>Recommendations</i>	19
-------------------------------	-----------

Chapter 2

Administrative Practices of the CLO Continue To Need Improvement	21
--	----

<i>Recommendations</i>	34
-------------------------------	-----------

Appendix A

Insurers in Conservation or Liquidation	37
---	----

Appendix B

Recommendations From Our Previous Report and the Results of Our Review of Corrective Action	41
---	----

Response to the Audit

Department of Insurance	47
-------------------------	----

Summary Results in Brief

- Confined resources are being used to improve the department's operations. The department's budget is not being adequately monitored. The department's Conservation and Liquidation Office (CLO) has had only limited success in closing estates.
- Despite improvements in planning and managing conserved insurers, budgets are not the department's adequately monitored. Conservation and Liquidation Office (CLO) has had only limited success in closing estates.

The Department of Insurance (department) is responsible for conserving and liquidating companies (insurers) that have financial or other problems, or that do not have authorization to transact insurance business in the State of California. During conservation, an insurance company is placed under court-ordered control to conserve the insurer's assets until the insurer's status is determined by the courts. If the insurance commissioner (commissioner) determines that it would be futile to rehabilitate the insurer in conservation, he may apply to the court for an order to liquidate the assets of the conserved company. Liquidation is a process in which the department's Conservation and Liquidation Office (CLO) converts a conserved insurer's assets to cash and applies it to outstanding debt. After completing this procedure, the commissioner is required by the California Insurance Code to apply for a court order to distribute the liquidated company's assets to the policyholders, creditors, and other groups owed by the insurer. After final distribution of the assets takes place and the CLO makes a declaration of that fact to the court, the closure of the insurer is complete.

In May 1994, the Bureau of State Audits issued a report stating that the department's Conservation and Liquidation Division (division) needed corrective action of poor management practices. We found that the division had not developed either a strategic plan for the conservation and liquidation of conserved insurers or management plans to close the estates of those insurers under its control. Further, we reported that the division had not developed adequate administrative practices to control effectively its costs for conservation and liquidation activities. In response to our audit, reviews by the Department of Finance, and the department's own internal investigations, the department reorganized the division into the CLO and relocated the unit to San Francisco to enhance communication with the department's other units and to improve the department's oversight of CLO activities.

The focus in this audit has been to do a follow-up review of the CLO's operations to determine the effectiveness of corrective action taken or planned regarding the recommendations of our previous audit.

We found that the CLO has developed a strategy and management plans for the conservation and liquidation of conserved insurers, including plans to close the estates under its control. However, it has had only limited success in distributing the assets of the liquidated insurers under its control and in ultimately closing their estates. As of November 1995, the CLO was managing 64 estates with assets available to pay claims. Between June 1994 and November 1995, the CLO made a final

distribution of assets for only six liquidated insurers. Accounting errors, incomplete claims records, and unresolved tax issues have impaired the CLO's ability to close estates readily. In addition, implementation of improvements in its processes was delayed when the department reorganized the division into the CLO and moved the entire operation from Los Angeles to San Francisco. Because of these conditions, we could not determine whether the CLO's strategy and estate management plans have been effective in maximizing the assets of conserved and liquidated insurers and distributing the assets at the earliest possible time.

Although the CLO has improved its policies and procedures for conservation and liquidation activities, we identified several areas requiring further improvement. Specifically, we found the following conditions:

- While the CLO has obtained computer software systems intended to add uniformity and efficiency to its accounting, budgeting, and claims processing activities, it has not fully implemented those systems.
- We also noted that although the CLO prepares budgets for its operations and the estates it manages, it does not calculate and report monthly on variances between budgeted and actual expenses even though it is required to do so by its own procedures.
- Although the CLO has twice revised its plans to close estates as part of its annual budgeting process, it does not have procedures to update frequently the closing plans for the estates it manages. Current estate planning information is important to ensure that the assets of conserved and liquidated insurers are maximized and to provide planning and budgeting information for the CLO's operations.
- The CLO sponsored a change in the Insurance Code, effective January 1, 1996, which allows for an expedited process for the closing of estates without sufficient assets to pay administrative costs or claims. However, the CLO and department legal staff have not yet determined timetables to close 10 of those estates now eligible for closure as a result of the change in the Insurance Code.
- We also noted that the CLO's efforts to identify and pay claims continue to be impeded by claims for which the validity or the dollar amount are not easily determined. The CLO cannot make final distribution of an affected estate's assets until the validity and dollar amount of all claims have been proven by the claimants and allowed by the courts. Based on a study of claims payouts prepared by its consultant, the CLO has identified 12 estates for which it anticipates paying claims until 2011 through 2020.

The positions and salaries established by the CLO are not civil service or under the guidelines set by state control agencies. Instead, under the supervision of the department, the CLO establishes positions and salaries with the guidance of its own policies and procedures. In 1994, we reported that the CLO based salaries for the division's executive-level personnel, managers, and other employees on wage and salary surveys that relied heavily on salaries paid in the private sector. During 1995, the CLO commissioned a new salary study and adjusted its salary scales to bring them up to date with new job specifications and responsibilities. However, we question the applicability of the 1995 salary study to the CLO, since this study also relied almost exclusively on comparable salaries paid in the private sector and in some cases exceed those established for state employees.

Although the CLO has made significant strides to develop its administrative practices, further improvement is needed. Because the department does not believe that the CLO is required to follow the administrative procedures practiced by most state departments, the CLO has created its own administrative policies and procedures for managing its activities. However, we found that the CLO does not always follow its policies and procedures for hiring employees and managing outside contractors. We also noted that the CLO has not established guidelines for borrowing from its investment pool to fund the cost of administering no-asset estates. In addition, we found that the CLO does not always properly allocate its indirect administrative costs to conserved and liquidated insurers.

Recommendations

The CLO should continue to improve and implement its plans to conserve and liquidate conserved insurers in a manner that maximizes the assets of liquidated insurers and distributes the assets at the earliest possible time.

To improve the effectiveness and efficiency of its operations, the CLO should take the following steps:

- Comply with its own procedures for monitoring the variances between the budgeted and actual expenses for its operations and the expenses of the estates it manages;
- Prepare and implement procedures to perform quarterly updates to closing plans for the estates it manages;
- Develop timelines for the rapid closure of those remaining no-asset estates that meet the provisions of the newly amended Section 1021 of the Insurance Code; and
- Continue to seek changes in the law that will allow the CLO to set reserves for contingent and undetermined claims and make distributions of the assets of liquidated insurers for proved and allowed claims.

The CLO should continue its effort to improve its administrative policies and procedures for the management of conserved insurers and liquidated insurers. In addition, the CLO should take the following specific actions:

- Ensure that future surveys conducted to adjust employee salaries include public sector comparisons;
- Establish processes to disclose the number of its permanent positions and the associated costs for each position in the governor's budget to the Legislature;
- Create and implement guidelines to ensure that borrowing from the investment pool complies with management's policies, and seek prompt reimbursement from the Insurance Fund to minimize the cost of borrowing charged to the Insurance Fund; and

Follow its procedures designed to ensure that its indirect costs are allocated in an equitable manner to the estates that benefit from those costs.

Agency Comments

The department generally concurs with the findings and recommendations in our report.

Introduction

Background

The authority for conservation and liquidation activities within the Department of Insurance (department) dates back to 1935. The department's Conservation and Liquidation Office (CLO) is responsible for conserving and liquidating insurance companies (insurers) that have financial or other problems, or that are not licensed to transact insurance business in California. Section 1011 of the Insurance Code authorizes the insurance commissioner (commissioner) to file with the courts to take possession of the assets of an insurer with financial or other problems, or of an insurer without a license. With a court order, the commissioner has authority to conserve the insurer's assets.

During conservation, the insurer is placed under court-ordered regulatory control to conserve its assets until the insurer's status is determined. If the commissioner determines that it would be futile to rehabilitate the insurer in conservation (conserved insurer), he may apply to the court for an order to liquidate its assets. Liquidation is a process by which a conserved insurer's assets are converted to cash and applied toward its outstanding debt. According to the CLO's chief executive officer, the department conducts most rehabilitation efforts before the courts order a failed insurer into conservation. He further stated that most conserved insurers placed under the management of the CLO have been liquidated.

After the CLO has liquidated the assets of a conserved insurer (liquidated insurer), the commissioner must apply for a court order to distribute the assets to policyholders, creditors, and other interested parties in the order required by the Insurance Code. The final distribution of assets and declaration to the court of that fact serves as closure of that insurer.

As of November 1995, the CLO was managing the estates for 99 conserved or liquidated insurers with total assets of approximately \$421 million. Of these 99 estates, the CLO identified 35 estates lacking assets sufficient to pay administrative costs or claims. For these estates, the CLO plans to ask the courts to allow the commissioner to abandon insolvency proceedings and close the estates. The CLO has identified an additional 8 estates that are holding the assets of others in trust, including escrow deposits and 401(k) deposits. It is managing the assets of the remaining 56 estates. These

totals do not include 9 estates under the control of the department but managed by special deputy receivers appointed by the commissioner. These conserved or liquidated insurers are outside the responsibility of the CLO. A table of the 99 estates, their states or countries of domicile, and their dates of conservation or liquidation appears in Appendix A.

The CLO's responsibilities in managing conserved and liquidated insurers consist primarily of reviewing claims not covered by insurance guarantee funds; determining amounts owed to the claimants; and taking action to identify, marshal, and manage the assets of insurers in conservation to maximize the return to policyholders and general creditors should a liquidation of assets become necessary.

A state insurance guarantee fund covers many policyholders of California-licensed insurers that are in conservation or liquidation. The California Insurance Guarantee Association (CIGA) and the California Life and Health Insurance Guarantee Association process and pay covered claims of insolvent property, casualty, life, and health insurers who are members of these associations.

The activities of the CLO to manage estates are funded by the conserved or liquidated insurers with sufficient assets to pay administrative costs. Annual appropriations from the Insurance Fund pay for CLO management of estates without sufficient assets to pay administrative costs. During calendar year 1994, CLO's total operating expenses were approximately \$15.3 million. These expenses do not include the costs of estates under the control of the department but managed by special deputy receivers appointed by the commissioner.

Historically, the department has interpreted the Insurance Code and long-standing case law as exempting the CLO from budgetary oversight by the Department of Finance; expenditure and financial statement oversight by the State Controller's Office; contracting and purchasing oversight by the Department of General Services; and personnel practices, salary administration, and travel policy oversight by the Department of Personnel Administration and State Personnel Board.

Results of Previous Audit by the Bureau of State Audits

In May 1994, the Bureau of State Audits issued an audit report entitled "Poor Management Practices at the Department of Insurance's Conservation and Liquidation Division Warrant the Department's Continued Action." During the 1994 audit, we found that the CLO's predecessor, the Conservation and Liquidation Division (division), had developed neither a strategic plan for the conservation and liquidation of conserved insurers nor individual management plans for the estates it supervised.

The report stated that the division should design such plans to maximize the assets of liquidated insurers and distribute the assets at the earliest possible time to prevent the drain of the estates' resources.

In addition, we identified poor management practices and inadequate procedures for important aspects of the division's operations, including inadequate preparation of budgets for the division and the estates it managed, questionable hiring practices and inadequate control over payroll costs, improper management of contracts for consulting and legal services, incorrect allocations of the division's operating costs to the estates whose assets fund the operations, and improper dispositions of the assets of liquidated insurers. We also found that the division did not always process claims promptly.

We recommended that the department improve its oversight of the division's activities to ensure that new policies established by the division operate as intended and are adhered to by the division. In addition, we made specific recommendations that the division prepare strategic and management plans for the conservation and liquidation of conserved insurers and improve its administrative practices.

The CLO's Reorganization and Staffing

In 1994, the department reorganized the division and created the CLO to carry out the commissioner's conservation and liquidation responsibilities. In April 1995, the department moved the CLO from Los Angeles to San Francisco, California, to improve communication with other units of the department, such as the legal division, that frequently assist the CLO. By relocating it to San Francisco, the commissioner also hopes to improve the department's oversight of CLO activities.

The CLO, which operates under the supervision of the deputy insurance commissioner for enforcement, is divided into three bureaus under the direction of a chief executive officer: the Estate Trust Bureau, the Financial Bureau, and the Operations Bureau. In the Estate Trust Bureau, an estate trust officer oversees five estate trust managers, who in turn manage all conserved and liquidated insurers. In the Financial Bureau, a chief financial officer oversees the data processing, accounting, investments, and reinsurance units. In the Operations Bureau, a chief operations officer oversees the administration, claims, and human resources units.

The CLO has established 55 permanent positions in its organization that are not within the State's civil service system. According to its chief executive officer, the CLO determines its staffing according to anticipated activity levels and a planned increase in efficiency. (See Figure 1 on the following page.)

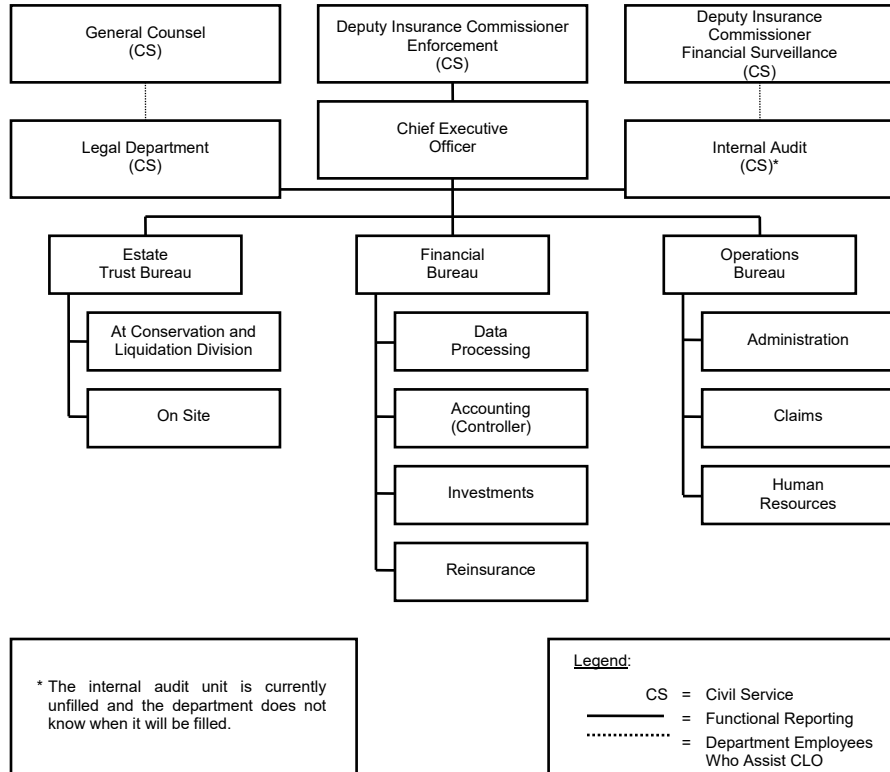
In addition to permanent staff positions, temporary workers, and department legal staff, the CLO engages the services of Department of Justice attorneys, private consultants, and private legal counsel for assistance in the conservation and liquidation of conserved insurers.

CLO Has Reorganized Its Conservation and Liquidation Responsibilities

The CLO's new organization plan outlines the tasks and responsibilities of its units during the conservation and liquidation of insurers. When an insurer is conserved, the CLO, along with department legal staff, work together to develop and implement a plan, adapted to the insurer's assets and business activities, and designed to secure the assets, books, and accounting records of the conserved insurer.

After it conserves the insurer, the CLO, along with any needed consultants, attempts to determine the causes of the conserved insurer's insolvency and its financial condition. The CLO then makes recommendations to the commissioner, who determines whether the conserved insurer can be rehabilitated or whether he should seek a court order to liquidate the company's assets.

Figure 1
CLO Organizational Structure



Once the commissioner obtains an order from the courts for liquidation, the CLO develops and implements a plan to liquidate the assets of the insurer and identify its liabilities to policyholders, creditors, and other stakeholders. In addition, the CLO coordinates its efforts with its counterparts from other states to secure and sell assets and to identify claimants and legal issues related to the insurer's business activities outside California.

After the CLO completes its efforts to identify the claims against the assets of a liquidated insurer, it forwards any covered claims to the applicable insurance guarantee association for processing and payment. Claims not covered by associations are processed and paid by the CLO from the remaining assets of the estates.

According to the chief executive officer, the CLO is seeking a cooperative agreement with CIGA to eliminate duplicate claims processing. Some claims exceed amounts that CIGA is statutorily permitted to pay. For these claims, CIGA processes the claim and pays its portion and the CLO subsequently goes through the same process. Under the agreement, the CLO will rely on CIGA's determination of the portion of claims that the CLO is responsible to pay.

After an estate's assets have been liquidated and the claims liabilities against those assets have been proved and allowed by the CLO and the courts, the CLO makes a final distribution of the estate's assets to pay those claims in the priority sequence detailed in Section 1033 of the Insurance Code. A declaration to the courts that the CLO has complied with the court order for the distribution of assets closes the estate and discharges the responsibilities of the commissioner as liquidator.

Scope and Methodology

The purpose of this audit was to conduct a follow-up review of the CLO's operations to assess the effectiveness of corrective actions taken or planned regarding the recommendations from our previous audit. A listing of the 15 recommendations from our previous audit and the results of our review of the CLO's corrective actions are presented in Appendix B.

To evaluate its strategic plan for the conservation and liquidation of conserved insurers, we began by obtaining the CLO's mission statement and a listing of its goals and objectives. We noted the objectives that the CLO had accomplished and the strategies and progress for addressing the objectives that it had not accomplished. We also noted the improvements that the CLO

has implemented and those that are planned in the procedures and systems designed to carry out CLO's responsibilities.

To assess the quality of the CLO's efforts in preparing management plans for the conserved and liquidated insurers under its control, we evaluated its conservation and liquidation procedures and obtained its plans for closing the estates. We sampled the closing plans as of November 1995 for those estates with assets and conducted reviews of documents and interviews of CLO personnel to determine whether the closing plans are based on actual occurrences and reasonable timelines.

To review the CLO's efforts in preparing budgets for the insurers it manages, we evaluated its procedures for budgeting and monitoring the costs of its operations and costs related to each of the estates. In addition, we examined the budget that the CLO prepared for calendar year 1996 to determine whether it incorporated all costs of CLO activities, including costs for consulting and legal services. We also performed procedures to determine whether the CLO's budget is based on planned conservation and liquidation activities. Further, we evaluated the CLO's budget-monitoring activities during 1995 to determine whether the CLO is using its budget to control operating costs and the costs of managing conserved and liquidated insurers.

To review the CLO's contracting practices, we evaluated its procedures for acquiring and managing consulting contracts. Because the CLO considers itself exempt from the procurement oversight of the Department of General Services, it has developed its own contract procedures. We evaluated the CLO's contract procedures against the requirements of the Public Contract Code and the State Administrative Manual to determine if the procedures are adequate to ensure that it receives acceptable goods and competent services at competitive prices. In addition, we reviewed contracts awarded during 1995 and contractors' billings to determine whether the CLO complied with its procedures for awarding and managing contracts.

Finally, we performed procedures to assess the effectiveness of the corrective action taken or planned by the CLO for each of the recommendations from our previous report. These procedures included reviewing the adequacy and effectiveness of the related internal accounting and administrative controls.

Chapter 1

The CLO Has Developed Plans for Conserved Insurers but Has Achieved Only Limited Success in Liquidating Them

Chapter Summary

Since May 1994, when we completed an audit of what was then called the Conservation and Liquidation Division (division), the Conservation and Liquidation Office (CLO) has made progress in its efforts to manage conserved and liquidated insurers. We found that, although it needs to refine its plans, the CLO has developed a strategy along with goals and objectives to fulfill its mission. In addition, it has taken steps to develop policies, procedures, and management plans for the estates under its control, including closing plans for all estates.

However, the CLO has had only limited success in distributing the assets of liquidated insurers to claimants and closing the liquidated insurers. We noted certain events that may have hindered the CLO's effort to close more estates than it did. As of November 1995, the CLO was managing 64 estates with assets available to pay claims filed against them. Between June 1994 and November 1995, the CLO made a final distribution of assets for only six liquidated insurers. Accounting errors, incomplete claims records, and unresolved tax issues have impaired the CLO's ability to close estates readily. Further, implementation of improvements in its processes was delayed when the department reorganized the division into the CLO and moved the entire operation from Los Angeles to San Francisco. Accordingly, we could not determine the effectiveness of CLO's strategy and estate management plans to maximize and distribute the assets of conserved and liquidated insurers.

Although the CLO has developed closing plans for the conserved and liquidated insurers under its management, it does not have procedures to update those closing plans frequently. Because two objectives of the closing plans are to maximize the assets of conserved and liquidated insurers and provide planning and budgeting information for CLO operations, the CLO cannot ensure that the plans are effective, relevant, and meeting those objectives unless it updates closing plans frequently.

The CLO Has Developed Written Policies and Procedures for Its Activities

Since our May 1994 report, the CLO has developed and implemented written policies and procedures for the conservation and liquidation of insurers that outline the tasks and responsibilities of the CLO's bureaus. These procedures include steps intended to secure the assets and business records of conserved insurers and to establish timelines for the accomplishment of critical tasks. In addition, the CLO coordinates with guarantee funds and receivers from other states to secure all assets and ensure consistency and reciprocity between California and receivers from other states.

The process whereby the CLO takes possession of the assets, books, and accounting records of a conserved insurer is called the "takedown." During the takedown, the estate trust managers are responsible for coordinating the activities of the various CLO staff and department legal staff working on the takedown. The estate trust managers analyze the insurers to be conserved and develop specific takedown plans using the pertinent steps of its procedures. We reviewed the files for three takedowns performed during 1995 and found that the CLO followed its established steps for takedown plans.

The CLO Has Adequate Procedures for Asset Disposition

The CLO's written procedures for the disposition of an insurer's assets require that the CLO use a public sale or solicitation of bids to dispose of all assets to be sold. Further, it prohibits its employees from purchasing any of these assets. We found that the CLO has followed these procedures. Specifically, we reviewed the disposition of the assets of five liquidated insurers during 1995 and found that the CLO conducted advertised public auctions for two insurers and received two bids for the assets of a third liquidated insurer. For the remaining two estates, the assets belonged to others and were not sold.


The method of disposition of an insurer's assets depends upon the type of asset. Some assets may be leased, may be the personal property of the insurer's employees, or may lack sufficient value to pay the cost of disposition. CLO policy is to return leased property and personal property to the owners. Assets without sufficient value to pay the cost of disposition are donated to charity or abandoned, a practice that we agree is reasonable. Under the estate trust managers' oversight, the CLO contracts with realtors to sell the real property of liquidated insurers. Under the supervision of a manager in the Operations Bureau, the furniture, fixtures, and equipment of a liquidated insurer receive an independent appraisal and are sold at a publicly advertised auction.

Despite Improved Procedures, Claims Processing Continues To Impede the CLO's Progress in Closing Estates


The CLO is responsible for processing some claims against liquidated insurers. It has developed written procedures to identify and approve or reject claims against the estates it manages that are not covered by an insurance guarantee association. In addition, it also monitors those claims processed and paid by insurance guarantee associations.

The Insurance Code requires the CLO to notify potential claimants of a liquidated insurer and validate all claims before it can distribute the assets and close the estate. However, the CLO remains unable to efficiently process claims against liquidated estates because its claims records are incomplete.

Section 1021 of the Insurance Code requires that the commissioner notify potential claimants of a liquidated insurer and have them submit their claims along with proof of the claims within six months to one year, as determined by the commissioner. For claims against liquidated insurers who are authorized to transact insurance in the State, the CLO forwards the claims to the California Insurance Guarantee Association (CIGA) for processing. The CLO is responsible for paying claims not covered by, or outside the statutory payment limits of, CIGA. However, before it pays any claims within its responsibilities, the CLO must determine whether the estate has assets sufficient to cover the payments.




Because records are incomplete and lack uniformity, claims processing is inefficient.




According to the operations officer responsible for claims processing, the incomplete condition of the claims records prevents the CLO from knowing the number or status of claims filed against many of the estates under its management. Before the reorganization, the department did not keep claims records in a uniform manner. According to the management information services (MIS) unit manager, the department previously used more than one electronic database to record and maintain claims information. In addition, it did not use uniform codes to file data critical to locating information within the databases. Further, some employees used their own unique electronic spreadsheets to maintain claims information. As a result, it has been impossible for the CLO to use the existing databases to produce comprehensive reports of claims information. Moreover, according to the MIS manager, the claims information contained in the existing databases is incomplete. When the MIS unit converted the claims files for one estate, it found the information in the databases to be only 47 percent complete when compared to the source documents.

The CLO cannot rely on the existing databases for claims information necessary to determine the final distribution of a liquidated insurer's assets. Therefore, a manual search of claims documents being held in storage and on the premises must be conducted to assess the number and status of claims against an affected estate. If the CLO cannot be sure that it has identified all claimants of a liquidated insurer, it must repeat the public notice process requesting the submission of claims. As of November 1995, the CLO had at least 43,000 boxes of claims documents in storage for estates with assets and at least 9,800 boxes in storage for estates with little or no assets. Until the CLO can effectively manage the data contained in storage and in the various databases, claims processing will continue to hinder efforts to close liquidated estates.



The CLO is currently installing software intended to improve claims processing; however, it will take three years to complete the conversion.



The CLO is installing a software system to maintain claims records. The new software uses a file format that is standard to the insurance industry and should increase the efficiency of efforts to identify the number and amount of claims against liquidated insurers. However, fully converting the claims files to its new system will require that the CLO inventory all claims documents and enter the results into the system. The CLO estimates it will take approximately three years during the course of its normal business process to inventory and convert its claims records into the new system.

The procedures for final distribution of assets and the closing of a liquidated estate require a cooperative effort among CLO units and department legal staff to ensure that all steps of the liquidation and closing plans have been performed properly. The steps leading up to final distribution include verifying that the claims process is complete, all receivables have been collected, reserves have been set for final and closing expenses, and a final accounting of the estate's assets and financial transactions has been prepared.

The CLO Has Obtained but Not Fully Implemented Computer Software Systems for Accounting Operations

During 1995, the CLO acquired computer software systems for its accounting and claims processing activities. When fully implemented, these systems are intended to increase the efficiency and effectiveness of its operations. The Financial Bureau installed the accounting system to provide uniform general ledger and reporting capabilities. Additionally, the system provides on-line access to accounting and budget information for CLO operations and for each estate it manages. However, the Financial Bureau has not fully used the reporting capabilities of its new system.


Although the system offers many management reports, including reports on asset distributions, estate financial information, value

and status of property and equipment, actual and budgeted expenses, and yearly trends of activity, the CLO is unable to use this resource fully. According to the controller, the workload associated with converting the records for the CLO and the estates it manages into the new accounting system has prevented the CLO from implementing all the reports the system offers.


Annual Budgets for CLO and Conserved Estates Are Not Always Monitored

To more closely monitor its operations and the estates it manages, the CLO implemented procedures to develop and follow annual budgets. However, we found that it does not calculate or report monthly on the variances between budgeted and actual expenses for its operations and the estates it manages even though this is required by its procedures.

We found annual budgets are based on staffing requirements for anticipated activity levels and on planned nonemployee expenditures, such as contracts, travel, furniture, and equipment purchases. Department managers, along with estate trust managers, are responsible for budgeting and controlling the costs of their departments and for estimating the total direct expenses they expect for each estate.



Budget monitoring efforts reveal accounting errors and are a tool to control spending.




However, the CLO does not calculate or report monthly on the variances between budgeted and actual expenses even though it is required to do so by its procedures. Up to November 1995, the CLO controller produced only one budget variance report as of June 30, 1995.

Additionally, the June 1995 budget variance report revealed some accounting errors. For example, accounting entries for approximately \$29,000 in expense-related transactions recorded directly to the estates were incorrect. This amount included a refund of insurance costs of \$1,430 that was incorrectly recorded to an estate. Also, the accounting department had improperly recorded as litigation expense the release of restricted assets totaling \$26,530, held pending a court decision. If it had not compared its actual expenses to budgeted expenses, the CLO may not have identified these errors in recording costs to the estates it manages.

According to the controller, the accounting unit was able to prepare only one budget variance report for the first six months of 1995 because of the heavy workload of converting the accounting records to the new on-line accounting system. However, without adequate monitoring of its budgets, the CLO cannot be certain it can properly control the costs of its operations and the costs of the estates it manages, or quickly detect and correct accounting errors.

The CLO Has Had Limited Success in Closing Estates

During our previous audit, we criticized the division for not establishing the management plans necessary to fully protect the assets of liquidated insurers and distribute the assets at the earliest possible time. Without management plans projecting the work necessary to conserving and liquidating the conserved insurers, the division could not effectively determine its staffing requirements. In addition, without established milestones toward the closure of liquidated insurers or target dates by which key actions must occur, the division could not be sure it effectively and efficiently managed the assets of the insurers.


Accounting errors, incomplete claims records, and unresolved tax issues have impaired the CLO's ability to close estates.

Although the CLO has prepared closing plans for all the estates under its supervision, it has had only limited success in distributing the assets of liquidated insurers to claimants and thereby in closing the estates. As of November 1995, 99 estates were under its management. Of those 99 estates, 64 estates had assets available for distribution to claimants. However, the final distributions of assets for only 6 estates took place between June 1994 and November 1995. The CLO's ability to close estates readily has been impaired by accounting errors, incomplete claims records, and unresolved tax issues. Because its estate management plans have been implemented only recently, and because the new claims and accounting systems are not fully in place, we could not assess the effectiveness of these changes in closing estates and in fully protecting and distributing the assets of conserved and liquidated insurers.

The CLO Has Developed Plans To Close the Insurers It Manages

The CLO manages 65 domiciliary insurers and 34 ancillary insurers. Domiciliary estates are created for those conserved insurers incorporated in California. An ancillary insurer is an insurer incorporated in another state or country. According to Section 1064.3 of the Insurance Code, when an ancillary insurer with operations in California is conserved, the court generally appoints the commissioner as the ancillary receiver. As the ancillary receiver, the commissioner has the sole right to recover and liquidate the ancillary insurer's assets located in California, pay certain priority claims established and allowed by the court, and pay necessary expenses of the proceedings. The code requires that remaining assets of ancillary estates are to be transferred promptly to the receiver located in the ancillary insurer's state of incorporation.

Fifty-six of the 99 estates under CLO's management have assets to pay administrative costs or claims. Of these 56 estates, 3

estates have less than \$150,000 in liquid assets and are classified as low-asset estates. An additional 8 estates have assets, such as escrow deposits and 401(k) plans, that are being held in trust by the conserved insurer. With less than \$100,000 in assets, the remaining 35 estates are classified as no-asset estates and are deemed to be without assets sufficient to pay claims in excess of CLO administrative costs. Table 1 shows, by category, the open estates under the supervision of the CLO as of December 1995.

Table 1
Open Estates Under the Supervision
of the CLO as of December 1995

	Estates by Category				Total
	Without Assets	With Low Assets	With Assets	With Assets Held in Trust	
Domiciliary estates	18	3	39	5	65
Ancillary estates	17	0	14	3	34
Total	35	3	53	8	99

Not frequently updating plans for closing estates limits the CLO's planning and budgeting information.

Although the CLO has prepared closing plans for all 99 estates, it has no procedures to update the closing plans frequently or routinely. According to the estate trust officer, his goal is to perform quarterly updates to the closing plans. However, this goal has not yet been met, although the plans were revised in January 1995 and November 1995 as part of the annual budgeting process. Two of the objectives of the closing plans are to maximize the assets of conserved and liquidated insurers and provide planning and budgeting information for CLO operations. However, without more frequent updates of those closing plans, the CLO cannot be assured that it has met those objectives.

Closing plans for each estate are prepared from a set of master procedures identified to conserve and close insurers. The plans identify timelines and detail specific tasks to be performed by the various units of the CLO and the department's legal staff. They also provide steps for disposition of assets, claims processing and payment, final accounting of the estate's assets, final distribution of assets, and closing of the estates. We reviewed the closing plans for 5 of the 56 estates with assets and found that the CLO appeared to have analyzed adequately any insolvency issues needing resolution for these estates. Also, we found that the sequence of events included in the plans appears to be logical and the plans appear to be set to reasonable timelines.

According to the chief executive officer, priority for closing estates is established based on factors that include adhering to court orders, meeting the needs of the claimants whenever possible, applying resources to estates where the CLO can produce results, and reducing the number of open estates. The CLO plans to close 42 estates during 1996. Table 2 shows the breakdown of domiciliary and ancillary estates to be closed in 1996.

Table 2

Planned Estate Closings for 1996

	With Assets	Without Assets	Total
Domiciliary estates	8	9	17
Ancillary estates	11	14	25
Total	19	23	42

1995 Legislation Makes It Easier To Close Estates That Have No Assets

Under newly amended Section 1021(c) of the Insurance Code, effective January 1, 1996, when the commissioner determines that an insolvent insurer does not have sufficient assets to pay claims or the commissioner's administrative expenses, he may decline to process claims made against the estate and ask the court's permission to abandon insolvency proceedings and immediately close the estate. The closing plans identify 20 domiciliary estates and 20 ancillary estates with no or low assets, or assets held in trust for others. In other words, these estates are not able to pay administrative costs and are eligible for closure under the new provisions of Section 1021. The department's legal staff is working with the receivers in other states for 17 of the ancillary estates to arrange the transfer of any records that the CLO may possess for these estates. Fourteen of these 17 ancillary estates are planned for closure during 1996. In addition, 9 of the 20 domiciliary estates are scheduled for closing in 1996. However, we identified closing plans for 10 domiciliary estates that did not specify a timeline for closing.

◆

The commissioner may abandon insolvency proceedings for estates with insufficient assets to pay administrative costs.

◆

Plans for Closing Estates With Assets

For those estates with assets, we found closing dates in all but six closing plans. According to the chief operations officer,

closing dates for these six estates cannot be determined because of long-tailed liabilities, Internal Revenue Service issues, and complications from unlawful activity on the part of the directors and officers of some of the conserved or liquidated insurers.

Table 3 shows the timelines for closing estates with assets.

Table 3

Planned Closings for Asseted Estates

	Closing in 1996	Closing From 1997 to 2001	Long-Tail Liabilities	No Closing Dates	Total
Domiciliary estates	8	22	12	5	47
Ancillary estates	11	5	0	1	17
Total	19	27	12	6	64

The CLO plans to close 27 estates with assets during the period 1997 through 2001. According to the closing plans, the time needed to close these estates is required primarily to process claims against the estates.

Twelve estates have long-tail liabilities and projected closing dates ranging from 2011 to 2020. These closing dates are based on a study, prepared by the CLO's consultants, of expected payouts of claims related to the types of insurance coverage that the insolvent insurers had sold. Claims may be filed against an estate that are contingent and undetermined (C&U). These are claims in which the validity or amount of the claim cannot be determined within the six-month to one-year filing requirement of the Insurance Code, Section 1021. Examples of C&U claims are workers' compensation, medical malpractice, and product liability. Provisions of Section 1025 of the Insurance Code specify that after these claims have been approved, they share the same payment priority as all other claims of the same class. Accordingly, final distribution of an affected estate's assets to claimants cannot be made and the estate cannot be closed until the validity and amount of C&U claims have been proven and allowed, or rejected.

Due to long-tail liabilities, some estates are not expected to be closed until the year 2020.

In 1995, the CLO unsuccessfully sponsored legislation to amend Section 1025 of the Insurance Code and allow the courts to set final determination dates for claims for which claimants had not provided proof of the amount of their claims. This proposed amendment would have allowed the commissioner to ask the courts to authorize the CLO to establish reserves for those unproven claims based on the opinions of actuarial and other experts, and to make distributions of the insurer's assets for proven claims in amounts that would not jeopardize the reserves. The department believed that these code changes would not sacrifice the security of amounts to be distributed to other claimants and would allow conservation and liquidation proceedings to proceed more rapidly, resulting in savings in cost and time. Nevertheless, the measure failed to generate sufficient legislative support for passage.

Conclusion

The CLO has made improvements in its efforts to manage conserved and liquidated insurers. It has developed a strategy and management plans for the conservation and liquidation of conserved insurers, including closing plans for most of the insurers it manages. However, it has had only limited success in distributing the assets of the liquidated insurers and closing their estates. We noted certain circumstances that may have hindered its efforts to close more estates than it did.

In addition, the CLO has taken steps and has planned further actions that will increase the effectiveness and efficiency of its operations. It has written policies and procedures for managing conserved and liquidated estates and for monitoring its own administrative activities. The CLO also has acquired computer software systems to standardize its accounting and claims records and has sponsored changes in the legislation that should streamline the closing of certain estates. However, we noted that the CLO should further improve its operations by fully implementing its policies and procedures and its computer software systems.

Recommendations

The CLO should continue its efforts to improve and implement its plans to conserve and liquidate conserved insurers in a manner that maximizes the assets of liquidated insurers and distributes the assets at the earliest possible time.

To improve the effectiveness and efficiency of its operations, the CLO should take the following specific actions:

- Fully implement and use the reporting capabilities available from its accounting system;

- Comply with its procedures to monitor variances between budgeted and actual expenses for CLO operations and the estates it manages;
- Prepare and implement procedures to perform quarterly updates to closing plans for the estates it manages;
- Develop timelines for those remaining no-asset estates that can be closed in accordance with the newly amended Insurance Code, Section 1021;
- Continue to seek changes in the law that will allow the CLO to set reserves for contingent and unliquidated claims and make distributions of the assets of liquidated insurers for proven and allowed claims; and
- Continue to improve the integrity of the claims files and fully implement its new claims processing system to increase the effectiveness and efficiency of its claims processing.

Blank page inserted for reproduction purposes only.

Chapter 2

Administrative Practices of the CLO Continue To Need Improvement

Chapter Summary

Although the Conservation and Liquidation Office (CLO) has taken significant steps to operate in accordance with prudent administrative policies and procedures, further improvement is needed. Specifically, we found that the CLO does not always follow its policies and procedures for hiring employees and managing its consulting contracts. In addition, we noted that it has not established guidelines for borrowing from its investment pool to fund the costs of administering no-asset estates and does not promptly seek reimbursement from the Insurance Fund. In addition, the CLO does not always properly allocate indirect administrative costs to conserved and liquidated insurers. Finally, the surveys used to determine the salaries and wages of its 55 permanent positions rely almost exclusively on comparable salaries paid in the private sector.

Because the Department of Insurance (department) believes that it is not required to practice the administrative procedures followed by most state departments, the CLO has created its own administrative policies and procedures for managing the activities of conservation and liquidation for the estates in its trust. Under the department's interpretation of the code and long-standing case law, the CLO is exempt from budgetary oversight by the Department of Finance; expenditure and financial statement oversight by the State Controller's Office; contracting and purchasing oversight by the Department of General Services; and personnel practices, salary administration, and travel policy oversight by the Department of Personnel Administration and State Personnel Board.

The department believes that oversight of the CLO's operations is provided by the internal management of the department, superior courts (where conservation and liquidation matters are reviewed), along with audits of the financial statements of the CLO and the estates it manages. Section 1061 of the California Insurance Code requires the Department of Finance to conduct these financial statement audits at least every two years and report the results to the commissioner and to the courts. However, for calendar years 1994, 1995, and 1996, the Department of Finance has allowed the CLO to contract for the audits with an independent audit firm.


The CLO Develops Its Own Personnel Policies and Procedures

The CLO has established 55 permanent positions that are not within the State's civil service system. Because it considers itself exempt from civil service requirements, the CLO does not establish positions and salaries under the State Personnel Board guidelines. Instead, the CLO, under the department's supervision, follows its own policies and procedures when establishing positions and salaries.


Surveys Used To Determine Salaries and Wages Rely Almost Exclusively on Private Sector Data

During our previous audit, we reported our concern that salaries for the Conservation Liquidation Division executive-level personnel, managers, and other employees were established based on wage and salary surveys that relied almost exclusively on salaries paid in the private sector.

These wage and salary surveys, which a consultant prepared in 1994, used primarily competitive market data from the private sector. The executive survey used information drawn from various salary studies of the insurance, banking, and financial industries representing companies with varying ranges of assets under their management and in different geographic locations.



Executive salaries are drawn from the insurance, banking, and financial industries without considering comparable government positions.



The consultant in charge of these surveys stated that she was instructed to use comparative executive salaries of insurance companies managing assets in the range of \$200 million to \$500 million for the executive survey and to use salaries from local insurance and noninsurance industries for the manager and employee survey. Further, she stated that the then chief of enforcement and special deputy wanted the consultant to survey the private sector, which was the market from which they planned to recruit.

Although we determined that the methodology used by the consultant in formulating the recommended salary levels shown in the salary surveys was appropriate, we questioned whether the surveys should have relied so heavily on private-sector data. In comparing the salary scales for the CLO's manager and other employee positions to similar civil service positions with similar levels of responsibility and expected expertise, we found the differences in salaries ranged from 23 percent less to 26 percent greater than salaries for the similar civil service positions.

|

In September 1995, the CLO commissioned a new study of its salary scales, benefit plans, and performance benchmarks. The study's stated purpose was to ensure that the CLO remains competitive in the hiring and retention of personnel. According to the chief executive officer, the purpose of the 1995 salary study was to bring the salary scales up to date with new job specifications and responsibilities. We found that this study also relied almost exclusively on private-sector data. Table 4 below shows the increases and decreases in salary midpoints as a result of the 1995 salary study.

Table 4
Salaries Resulting From 1994 and 1995 Surveys

Position Titles	1994 Salary Midpoint	1995 Salary Midpoint	Difference	Percent Difference
Receptionist or File clerk	\$ 23,300	\$ 19,395	\$ (3,905)	(17)%
Computer operator or Clerk	25,800	22,677	(3,123)	(12)
Technician or Administrative assistant	31,700	29,249	(2,451)	(8)
Reinsurance or Accounting technician	25,800	32,531	6,731	26
Executive secretary	36,700	35,812	(888)	(2)
Accountant or Senior claims examiner	35,000	48,957	13,957	40
Reinsurance or Accounting supervisor	49,200	55,520	6,320	13
Estate trust manager	66,000	71,947	5,947	9
Controller	66,000	75,228	9,228	14
Estate trust officer	130,000	111,081	(18,919)	(15)
Chief operations officer	115,000	137,250	22,250	19
Chief financial officer	150,000	163,419	13,419	9
Chief executive officer	195,000	314,067*	119,067	61

* Not approved by the department nor implemented by the CLO.

With the exception of the salary for the chief executive officer, the salary scales from the 1995 study have been approved by the department and implemented by the CLO. During 1995, the CLO upwardly adjusted the salaries to the new scales at the time it assessed employees' performance and granted merit salary increases. Pay was not lowered for those positions experiencing a downward move in salary scale. Instead, as current employees vacate these positions for other employment opportunities, replacement employees would be paid at the lower salary.


According to the chief executive officer, the 1995 study gave some consideration to public-sector salaries. Specifically, the


study included salary information from the State Workers' Compensation Insurance Fund. However, the chief executive officer said that many of the CLO's operations are unlike any in the public sector and that the responsibilities and salaries from organizations in the public sector are not always comparable.

Similar to our conclusion in 1994, we believe that in conducting salary studies, the CLO should have, at a minimum, surveyed organizations in other states that have similar responsibilities. We did a telephone survey and found two other states, New York and Illinois, that have conservation and liquidation responsibilities that are similar to those in California and that could have been included in the salary study. Moreover, these two states have established pay scales for their employees using studies which included comparisons to public-sector salaries.

The CLO Does Not Always Follow Hiring Procedures

We reviewed the applications for 10 of 32 new hires since October 1994 and found that, despite the CLO's development of procedures for hiring, one applicant did not meet the minimum qualifications of the position into which the employee was recruited. Specifically, the CLO hired at midpoint in the salary range an applicant who had only three years' experience and did not possess a professional license to fill a position with minimum requirements of seven years' experience and a professional license.


One employee was hired who did not possess the required professional license and experience.


Job class specifications ensure that applicants hired into positions in the organization have the knowledge and experience to perform the duties assigned to those positions. These specifications include requirements for job skills and minimum qualifications for experience and education, professional license, and job knowledge. Furthermore, salary scales are intended to compensate individuals who meet these standards. When the CLO does not follow its hiring guidelines, it cannot be certain that it has recruited personnel qualified to meet the requirements of its positions and may be improperly compensating individuals for qualifications that they do not possess.

The CLO Could Not Support Severance Payments

The CLO could not provide the legal opinions or accounting records to support the severance payments it made in September 1994 to employees who separated from its employment as a result of the closure of its Los Angeles office. Although nothing came to our attention that led us to believe that the severance benefits should not have been paid to the

employees when they separated from employment, without the legal opinions or the accounting records we could not determine the appropriateness of the payments to these employees.

In 1994, we reported that the division made improper severance payments totaling \$90,000 to employees who had not severed their employment with the division. The CLO requested that its employees voluntarily repay the severance benefit payments. As a result, approximately \$14,300 of the improper severance payments was collected from 20 employees. When the Los Angeles office closed and operations relocated to San Francisco, all Los Angeles employees separated from the CLO. Upon advice of its legal counsel, the CLO determined it owed severance benefits to the separated employees as a result of the move to San Francisco. To satisfy its obligation, the CLO returned the \$14,300 in severance pay that its 20 former employees had voluntarily repaid. According to the chief executive officer, he authorized the repayments based on opinions from department counsel and outside legal counsel that severance payments were required by the employment contracts of those separated employees. However, the CLO could not provide to us a copy of the opinions from its legal counsel nor detailed support that it had collected \$14,300 in voluntary repayments from its former employees before it repaid them.

The CLO has terminated its severance policy and no longer enters into employment contracts that require severance payments.

The CLO Did Not Always Follow Its Procedures for Awarding and Managing Contracts for Professional Services

We reviewed 5 of 34 contracts for consulting services entered into since May 1994 and the related billings, totaling approximately \$1.5 million. We found that the CLO does not always follow its procedures for awarding and managing contracts for professional services. For example, we found that the CLO did not always seek competing bids for consulting contracts, made payments to contractors that were not in strict accordance with the terms of the contract, and paid invoices that did not contain the required detail of the contractor's expenses.

In response to our previous audit, the CLO has developed professional services contract procedures that are modeled, in part, after the consulting contract requirements of the Public Contract Code and the State Administrative Manual. Critical elements of the procedures include proper approval for contracts, written agreements between the CLO and each contractor that detail the rates to be paid to contractors, detailed descriptions of services that are being contracted for, and timetables for the contractor's performance. In addition, the

procedures require competing proposals from at least three potential contractors.

The CLO Did Not Always Seek Competing Bids

—◆—
Three of the five contracts we received were not competitively bid.
—◆—

Despite the procedures requiring competitive bids, for three of the five contracts we reviewed, the CLO did not seek competing proposals as required by its contracting procedures. It awarded one contract to a consultant who performed data-processing services. The second contract was awarded to a consulting firm that operated the CLO's reinsurance unit under the oversight of the chief financial officer. The third consulting agreement provided expertise for claims-processing issues. According to the chief executive officer, a contract was awarded for the operation of its reinsurance unit without competing bids because the CLO needed to fill an unexpected shortage in staff caused by an October 1994 delay in its move to San Francisco. The CLO further stated that it awarded the contract for claims consulting services without acquiring competing bids because of prior satisfactory experiences with the contractor. The manager of the management information services unit said that he recommended the contract award for data-processing services based on inquiries he made of two firms that provided the services he needed.



Because the CLO did not claim emergency or sole-source justification for the award of these contracts, it failed to follow its established procedures and did not allow for competition in the award of these contracts. Without competing bids, the CLO cannot be certain that it is allowing all contractors to participate in a competitive process for the contracts it awards and cannot be assured it hired the most qualified contractor at the most appropriate cost.

CLO Spending Was Sometimes Outside the Terms of the Contracts

The CLO did not always properly manage its professional services contracts. Of the five contracts we reviewed, one contractor provided services totaling approximately \$13,900 before the contract was signed and approved by management. For another contract, the contractor provided services totaling approximately \$103,400 after the contract had expired. However, the contract was later amended to extend the period and spending limit. Also, for those same two contracts, the CLO made payments to the contractors that exceeded the maximums specified in the contracts even though the original amounts were increased by amendment. For example, we found that one contract was overspent by \$66,000 when a contractor was paid a total of \$616,000 after the maximum amount was raised to

\$550,000. Spending limits are included in the terms of the contractual agreements to provide some assurance that amounts paid are reasonable given the services provided by the contractors.

The CLO Paid Invoices Without Detailed Receipts


The CLO reimbursed one contractor \$46,400 for expenses it could not determine were reasonable or allowable.


In our previous audit, we reported that the division had made questionable payments to outside consultants and law firms. During our current review, we also found that the CLO made payments to contractors from invoices that did not contain sufficiently detailed descriptions of expenses or supporting receipts. The contracts we reviewed allowed for the reimbursement of reasonable expenses. However, for one of the five contractors whose billings we reviewed, the CLO paid approximately \$34,100 for expenses identified on the contractor's invoices simply as "travel and expenses" and \$12,300 for expenses identified simply as "ground expenses." The contract required detailed descriptions or actual receipts to support that the expenses were reasonable. We assume that the contractor defined "ground expenses" as hotel and meal expenses as well as transportation costs. However, the manager who approved the invoices did not know or have the detail to support these charges. Without sufficient detail or actual receipts for reimbursable expenses, the CLO cannot be certain that it is reimbursing only reasonable and allowable expenses.

Changes in Acquiring and Managing Legal Services Contracts

In our previous audit report, we criticized the division for contracting for legal services without seeking competing bids, obtaining detailed written agreements, and establishing procedures to assist the division in managing the contracts. In response to our audit, the department transferred responsibility for acquiring and managing legal services contracts from the CLO to the department legal staff.

The department has developed written procedures for hiring legal services contractors that appear to be adequate to control the costs of outside legal counsel. The procedures require potential legal contractors to prequalify for selected services at approved billing rates. The procedures also require detailed written agreements that outline the services the contractor is to perform, the terms for performance of the services and compensation, and spending limits

for the services. The procedures also require the contractor to provide case plans and budgets and to give status reports on the legal services it provides.

The Department Does Not Always Adequately Monitor Contracts With Outside Legal Counsel


Inadequate monitoring of legal contracts resulted in the payment of excessive charges for travel and document copying.

We reviewed five of the agreements that the department entered into with the 12 outside legal consultants providing services to the CLO as of November 1995. We found that for the most part, the department followed its procedures for acquiring and managing legal services contracts. However, we also found that the department authorized the CLO to reimburse one attorney approximately \$700 twice for the same out-of-state travel. The attorney submitted an invoice for the travel expenses in June 1995 and submitted the same billing a second time in August 1995. Different members of the department's legal staff approved the two invoices for payment.

On a second contract, the department legal staff approved an amendment to the contract and authorized a \$30,000 spending increase on the contract one month after the contract had expired. The amendment expanded the scope of services to include advice on employment issues. For another contract, the department approved invoices with copy charges of up to 25 cents per copy even though the contract rate was limited to 10 cents per copy, resulting in a \$66 overcharge. Adequate monitoring of contracts and related billings provide some assurance that amounts paid to the contractors are reasonable and for services procured.

The CLO Overborrowed From Its Investment Pool, Resulting in Additional Cost to the Insurance Fund


The CLO administers an investment pool in which it deposits any excess cash from the conserved and liquidated insurers it manages. As of December 1995, the investment pool had a market value of approximately \$272 million. We learned the CLO has arranged borrowing from the investment pool to cover the costs of administering the estates of insurers lacking sufficient assets to pay those costs. According to the CLO, the broad powers granted to the insurance commissioner by Section 1035 of the California Insurance Code gives the CLO the authority to borrow from the investment pool. We are concerned that the CLO has overborrowed from the pool and has not repaid the pool in a timely manner.


The State's insurance fund incurs unnecessary costs to repay the investment pool when the CLO overborrows or is late to claim reimbursements.

The CLO incurs costs for estates without sufficient assets to pay those costs. These costs may include legal fees associated with closing the estates or records storage costs. Section 1035 of the California Insurance Code prohibits the CLO from using the assets of one estate to pay the costs of another estate. To cover the costs of managing estates with no assets, the CLO is appropriated money from the Insurance Fund. In each of fiscal years 1994-95 and 1995-96, the CLO received an appropriation of \$623,000 from the Insurance Fund. In addition, the CLO is able in some instances to recover assets on behalf of an estate which were not previously available to pay the estate's costs. When this occurs, the CLO uses the recovered assets to pay back the borrowing from the investment pool or to reimburse the Insurance Fund. However, when the CLO arranges borrowing from the investment pool to pay the costs of an estate for which it anticipates recovering assets, it cannot be certain of the amount or the timing of the recovery.

However, the appropriation from the Insurance Fund is not received in advance. This situation creates a lag between the time that the costs are incurred for no-asset estates and the time that monies are actually received from the Insurance Fund. Therefore, the CLO borrows from the investment pool to pay the expenses associated with no-asset estates until it receives reimbursement from the Insurance Fund. The chief financial officer told us that he was comfortable with a \$500,000 ceiling on borrowing from the pool given the present \$623,000 annual appropriation from the Insurance Fund, which we agree is a reasonable amount. However, the CLO far exceeded this amount by borrowing nearly \$900,000 during January through October 1995. Furthermore, the borrowing also exceeded the \$623,000 that was appropriated from the Insurance Fund for 1995.

In addition, the CLO did not seek prompt reimbursement from the Insurance Fund. In January 1996, the CLO submitted to the department a claim requesting \$900,000 in reimbursement from the Insurance Fund for expenses from January 1995 through October 1995.



The department is not prompt in paying CLO's claim for reimbursement.

We also found the department is not prompt in paying the CLO's claim for reimbursement once it is submitted. For example, for expenses from the period July 1994 through December 1994, the department did not provide reimbursement until November 1995, nearly a year later.


In order to reimburse the investment pool properly, the CLO charges the Insurance Fund for the interest accrued on the funds borrowed. As a result, when the CLO borrows from the investment pool in excess of its annual appropriation from the Insurance Fund, and when the CLO is not prompt in submitting and the department is not prompt in paying the claim for reimbursement, the Insurance Fund bears more cost than if the

investment pool had been promptly reimbursed. In addition, the CLO has not established a system for monitoring and repaying amounts borrowed from the investment pool; therefore, the CLO cannot determine when it has overused the investment pool as a source of funding for the costs of managing no-asset estates.

The CLO Is Overcharging Some Estates and Undercharging Others for Indirect Costs



The Insurance Code prohibits the CLO from charging one estate for the costs of another.



During our review, we found that the CLO is overcharging some estates while it is undercharging others for indirect costs. This occurred because the CLO does not always properly allocate indirect costs to the estates it manages. Each month, the indirect costs are accumulated in a cost pool and subsequently allocated to the estates that have benefited. The CLO charges some of its indirect costs to the estates in proportion to the number of hours employees have worked on a specific estate. For the remainder, the costs are charged in proportion to the number of outstanding claims for a particular estate. Both these methods are reasonable ways to allocate indirect costs.

However, we found errors in the data collected on the number of employee hours worked. As a result, the allocation of indirect variable costs is incorrect. For example, we found one estate was overallocated \$1,700, or 18 percent, of indirect costs. In addition, as we discussed in Chapter 1, because the claims records are incomplete, we found that indirect fixed costs were inaccurately allocated, but we could not assess the extent of the misallocation.

Moreover, we found that the CLO does not always charge indirect costs using the related month's data. Specifically, we found that the CLO improperly allocated \$247,000 in indirect costs to the wrong months. Allocation rates vary from month to month due to fluctuations in conserved insurer workloads, which serve as the basis for distributing these costs. Because the CLO sometimes allocated expenses in months other than those in which they were incurred, some insurers were charged more than their fair share of the expenses, and others were charged less.

Basic Principles of Cost Allocation


The purpose of cost allocation is to ensure that costs incurred that cannot be identified as directly benefiting a specific estate are charged to all the estates benefiting from those costs in an equitable manner. Equitably charging indirect costs to the estates the CLO manages is important so that some estates do not pay the administrative costs of others. Indirect costs generally include administrative costs, such as the cost of the

executive office, general administration, budgeting, accounting, personnel, and training. Indirect costs can be categorized as variable costs or fixed costs and are distributed to estates using different methods. Examples of indirect variable costs include salaries and wages and professional fees, and examples of indirect fixed costs are rent, utilities, and equipment depreciation.

***Labor Hours Used To Allocate
Variable Costs Did Not Agree With
Hours Reported on Employee Time Sheets***

Variable indirect costs are allocated based on the number of hours employees spend on each conserved insurer. These hours are determined from semimonthly time sheets. Every month, these time sheets are summarized by each estate managed on a cost allocation worksheet to show how many hours the employees spent on each conserved insurer during that month. Based on the hours recorded on the cost allocation worksheets, the CLO then allocates its variable indirect costs to the conserved insurers.

We reviewed the cost allocation worksheets for 12 estates during 1995 and found that, for 8 of those estates, the direct labor hours used to allocate approximately \$303,000 in indirect variable costs did not agree with hours reported by employees on their time sheets. For example, for one estate, the hours recorded on the cost allocation worksheet were 37 hours, or 31 percent, more than the time reported on the employee time sheets. For another estate, the hours recorded on the cost allocation worksheets were 12 hours, or 2 percent less than the hours reported on the employee time sheets.



*The accounting unit
does not ensure that
the number of hours
actually worked are
used to allocate indirect
variable costs.*

Because the method used to allocate costs to conserved insurers is based on employee hours, a conserved insurer that has not been charged for the appropriate amount of time will not absorb its fair share of indirect costs. Likewise, a conserved insurer that is overcharged time will absorb CLO costs for services the insurer did not receive. For example, we determined that one estate was overallocated approximately \$1,700 in indirect costs. For the two months in which we found allocation errors, the errors comprised almost 5 percent, or \$5,140 of the \$105,198 that was allocated.


We discussed our concern with the controller, who told us that the cost allocation worksheets contained incorrect hours because the CLO does not verify that the hours entered into the cost allocation worksheets each month agree with the employees' time sheets. Until the CLO establishes procedures to ensure that the hours from the allocation worksheets agree with the employees' time sheets, it cannot be certain that it is correctly charging the estates under its control for their fair share of indirect variable costs.

Proof of Claims Records Used To Allocate Fixed Costs Are Incomplete and Inaccurate

Indirect fixed costs are allocated based on the number of outstanding claims filed against the assets of each estate it manages. Each month, the CLO uses the number of claims outstanding for each estate, as reported by the claims unit, to allocate fixed costs such as rent, utilities, and equipment depreciation expense.



Although it is aware the claims information is incomplete, the CLO feels the number of claims is the best information available to allocate fixed costs.



However, the CLO does not have complete records of claims information for each estate. According to the operations officer who is responsible for claims processing, the CLO does not know the number or status of claims filed against most of the estates under its management due to the incomplete condition of its claims records. As a result, during the period January 1995 through November 1995, approximately \$992,000 in indirect fixed costs were allocated to the estates using percentages calculated with the incomplete claims information. When the CLO audited claims files for one estate, it found the claims reports to be only 47 percent complete when compared to the source documents. Because the extent of the incompleteness in its claims records is not known, we could not determine the effect of the misallocations on each of the estates.

According to the controller, although the claims information is incomplete, it is the best information available for allocating indirect fixed costs. The CLO is currently implementing a new claims processing system to improve the completeness of the claims information. However, the CLO anticipates it will take three years to inventory and input the claims records into the new system.

Conclusion

The CLO has made improvements in its administrative policies and procedures related to the management of conserved and liquidated insurers. However, we found that it does not always follow policies and procedures for hiring employees and managing outside contractors. In addition, the surveys that the CLO used to determine the salaries and wages of its 55 permanent positions rely almost exclusively on comparable salaries paid in the private sector. We also noted the CLO has overborrowed from its investment pool to fund the costs of administering no-asset estates and has not repaid the investment pool in a timely manner, resulting in additional cost to the Insurance Fund. In addition, we found that, because it does not always properly allocate its indirect

administrative costs to the conserved and liquidated insurers under its management, the CLO is overcharging some estates and undercharging others for indirect costs.

Recommendations

The CLO should continue its effort to improve its administrative policies and procedures for the management of conserved and liquidated insurers. In addition, the CLO should take the following specific actions:

- Ensure that future surveys conducted to adjust employee salaries include public-sector comparisons where appropriate;
- Disclose in the governor's budget the number of permanent, non-civil service positions in the CLO and the associated costs for each position;
- Adhere to its own policies for filling positions only with qualified applicants or provide justification for hiring applicants who do not meet the minimum qualifications;
- Fully implement and follow its contract procedures to ensure that contracts are competitively bid when appropriate, that contractors are paid in accordance with the terms of the contracts, and that invoices include adequate detail or support;
- Create and implement guidelines to ensure that investment-pool borrowing complies with management's policies; in addition, ensure that the pool receives prompt reimbursement from the Insurance Fund to minimize the borrowing charges to the Insurance Fund;
- Develop a system of review to ensure that indirect cost allocation worksheets are accurate and supported by actual hours charged by employees directly to estates each month; and
- Allocate indirect costs using the allocation percentages computed for the month the costs were incurred.

We conducted this review under the authority vested in the state auditor by Section 8543 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

Date: April 3, 1996

Staff: Steven M. Hendrickson, Audit Principal
Norm Calloway, CPA
Chris Ryan

Appendix A

Insurers in Conservation or Liquidation

	Company Name	Insurance	Country	Date	Date
1	Aegis Indemnity and Insurance Company	Property	British West Indies	5/20/94	6/6/94
2	AIM Insurance Company	Property	California	3/31/94	9/8/94
3	Allied Fidelity Insurance Company	Property	Indiana	5/5/86	6/2/86
4	American Mutual Insurance Company of Boston	Property	Massachusetts	3/9/89	5/3/89
5	American Mutual Liability Insurance Company	Property	Massachusetts	3/9/89	5/3/89
6	American Star Insurance Company	Property	Wisconsin	12/3/92	12/3/92
7	ANA Insurance Group	Property	Louisiana	12/11/92	7/7/94
8	Apex Placement Insurance Company Ltd.	Property	British West Indies	5/30/91	12/11/91
9	Bestland Insurance Agency	Agency	California	3/30/93	10/21/93
10	Builders Mutual Surety Company	Surety	California	2/13/85	10/11/85
11	Cadillac Insurance Company	Property	Mississippi	1/18/90	2/16/90
12	Cal-American Insurance Company	Property	California	5/21/93	6/30/93
13	California Benefit Life Insurance Company	Life	California	4/6/89	6/21/89
14	California Life Insurance Company	Life	California	4/25/86	7/3/86
15	California Pacific Life	Life	California	5/18/89	8/2/89
16	California Standard Indemnity Company	Property	California	9/6/85	10/1/85
17	Capitol Bond & Insurance Company	Surety	California	9/11/86	6/21/91
18	Carriers Insurance Company	Property	Iowa	1/21/86	2/20/86
19	Cal Farm Insurance Co.	Property	California	3/29/85	12/18/85
20	Chicago Title of Alameda County	Title	California	3/17/82	5/5/82
21	Citation General Insurance Company	Property	California	7/21/95	8/24/95
22	Coastal Insurance Company	Property	California	2/2/89	3/6/89
23	Comco Insurance Company	Property	Texas	10/31/91	12/24/91
24	Commerce Title	Title	California	12/20/89	1/18/90
25	Commonwealth Land Title of San Francisco	Title	California	11/19/84	6/18/85
26	Commonwealth United Insurance Co., Ltd.	Property	British West Indies	12/11/91	8/13/92
27	Consolidated Mutual Insurance Company of New York	Property	New York	11/30/78	6/26/79
28	Consumers Indemnity Company	Property	Washington	12/5/88	1/18/89
29	Dual Plus Insurance Co., Ltd.	Life	Bermuda	9/23/92	12/3/92
30	Edison Insurance Company	Property	Illinois	3/19/91	4/16/91
Shading indicates no-asseted estates.					
31	El Dorado Insurance Company	Property	California	8/2/78	12/11/78

	Company Name	Insurance	Country	Date	Date
32	Employers Casualty Company	Property	Texas	4/1/94	5/2/94
33	Employers National Insurance Company	Property	Texas	4/1/94	5/2/94
34	Enterprise Insurance Company	Property	California	11/26/85	2/24/87
35	Equity General Insurance Company	Property	Illinois	11/21/89	12/4/89
36	Expressway Insurance Agency	Agency	California	12/16/92	Pending
37	First California Property & Casualty Insurance Company	Property	California	9/6/89	10/30/89
38	First Capital Life Insurance Company	Life	California	5/14/91	Rehabilitated
39	First Centennial Title Company, Inc.	Title	California	9/27/83	12/9/83
40	George Washington Life Insurance Company of California	Life	California	10/5/90	5/28/91
41	Glacier General Assurance Company	Property	Montana	3/4/85	12/4/85
42	Golden West Insurance Exchange & Exchange Management	Property	California	4/18/84	6/13/84
43	Greater Indemnity and Casualty Company, Ltd.	Property	British West Indies	6/9/94	8/8/94
44	Great Falls Insurance Company	Property	California	5/25/88	11/5/88
45	Great Global Assurance Company, The	Property	Arizona	2/4/86	4/4/86
46	Great Republic Insurance Company	Life	California	7/1/91	1/24/92
47	Homeland Insurance Company	Property	California	5/6/87	9/25/87
48	Homestead Title Corporation	Title	California	8/29/94	Pending
49	ICB Surety Group, Inc.	Surety	Nevada	8/15/95	9/28/95
50	Ideal Mutual Insurance Company of New York	Property	New York	1/18/85	1/25/85
51	Imperial Insurance Company	Property	California	9/23/75	1/10/78
52	Integrity Insurance Company	Property	New Jersey	1/5/87	3/9/87
53	Inter-American Insurance Company of Illinois	Property	Illinois	1/15/92	2/10/92
54	Interco Underwriters Corporation and Exchange	Property	California	1/18/83	2/24/83
55	Investment Life Insurance Company of America	Life	North Carolina	5/13/93	7/14/93
56	KD Excess & Surplus Insurance Services	Agency	California	5/27/94	8/29/94
57	Legacy Life Insurance Company	Life	Nebraska	9/11/90	None
58	MCA Insurance Company	Property	Oklahoma	12/1/92	12/16/92
59	Midland Insurance Company	Property	New York	4/15/86	5/9/86
60	Millers National Insurance Company	Property	Illinois	5/26/93	6/24/93
61	National Colonial Insurance Company	Property	Kansas	7/26/93	8/16/93
62	National Service Insurance Company	Property	California	2/16/89	5/4/89
63	Oshima Reinsurance Company	Property	Belgium	1/29/91	3/12/91
64	Pacific Marine Insurance Company	Property	Washington	6/29/87	6/26/89
65	Pacific States Casualty Company	Property	California	3/1/93	7/1/93
Shading indicates no-asseted estates.					
66	Penniman Title Company	Title	California	3/6/92	3/12/92
67	Premier Alliance Insurance Company	Property	California	2/18/94	8/2/94

	Company Name	Insurance	Country	Date	Date
68	Premier Title	Title	California	5/5/94	6/16/94
69	Reserve Insurance Company	Property	Illinois	5/30/79	6/26/79
70	S & H Insurance Company	Property	California	1/28/85	4/16/85
71	Signal Insurance Company	Property	California	9/23/75	1/10/78
72	Stoddard Insurance Administration	Agency	California	5/13/93	12/18/93
73	Summit Title Company	Title	California	8/23/90	12/13/90
74	Superior California Title & Escrow	Title	California	8/23/90	12/18/90
75	Surety Insurance Company of California	Surety	California	5/23/84	8/20/84
76	Thriftco Insurance Company	Property	California	3/13/90	7/24/90
77	Title USA Insurance Corporation	Title	Texas	11/3/89	12/7/89
78	TMIC Insurance Company	Mortgage	California	4/14/86	4/27/88
79	Toma Surplus Lines Insurance Brokers, Inc.	Agency	California	6/2/93	Pending
80	Tower Indemnity Company	Property	California	12/11/64	6/1/65
81	Trans Cal Title Company	Title	California	3/25/91	5/21/91
82	Trans Continental Title Company	Title	California	1/7/88	7/14/88
83	Transit Casualty Company	Property	Missouri	12/4/85	1/8/86
84	Trico Title Company	Title	California	8/18/94	Pending
85	Tri-Star Insurance Company	Property	California	11/10/92	11/24/92
86	Underwriters Reserve Ltd.	Property	St. Kitts & W. Indies	5/20/93	9/9/93
87	United Bonding Insurance Company	Property	Indiana	3/10/71	8/20/71
88	United Community Insurance Company	Property	New York	12/22/94	1/12/95
89	United Equitable Insurance Company	Property	Illinois	10/16/90	11/8/90
90	United Home Enterprises	Home	California	4/22/81	12/8/81
91	West Atlantic Insurance Company, Ltd.	Property	British West Indies	4/13/94	4/13/94
92	Western Carriers Insurance Exchange and Underwriters	Property	California	4/27/83	5/12/83
93	Western Employers Insurance Company of America	Property	California	4/25/91	5/7/91
94	Western Employers Insurance Company	Property	California	4/2/91	4/19/91
95	Western International Insurance Company	Property	California	8/10/92	9/9/92
96	Western Star Insurance Company, Ltd.	Property	Florida	8/29/94	8/29/94
97	Westland Title	Title	California	11/15/94	1/13/95
98	Winfield Title Company	Title	California	3/5/81	5/15/81
99	World Title Company	Title	California	6/15/95	6/15/95

Shading indicates no-asseted estates.

Blank page inserted for reproduction purposes only.

Appendix B

Recommendations From Our Previous Report and the Results of Our Review of Corrective Action

The Conservation and Liquidation Office (CLO) took specific actions to address the following recommendations identified in our previous report:

- **Establish strategic management plans that include specific goals, milestones, and timelines for all the insurance companies under its management.**

Although the plan needs refinement, the CLO has developed a strategy along with goals and objectives to fulfill its mission. In addition, it has taken steps to develop policies, procedures, and management plans for the estates under its control. However, it has had only limited success in distributing the assets of liquidated insurers to claimants and in closing the liquidated estates.

- **Develop meaningful budgets based on the level of conservation and liquidation activities of the CLO and that include all the CLO's costs, including consultants' costs, to ensure effective monitoring of the CLO's expenditures.**

The CLO implemented procedures to develop meaningful budgets that include the costs of CLO operations and the costs for the estates it manages. The CLO based its budget on planned conservation and liquidation activities, including the costs of consultants. However, we found the CLO does not calculate and report monthly on the variances between budgeted and actual expenses for its operations and the estates it manages, as required by its procedures.

- **Fully implement and follow the recently developed performance management program manual to ensure that all merit salary increases and promotions are equitable and based on employee job performance.**

The CLO implemented the performance program manual to ensure that all merit salary increases and promotions were equitable and based on employee job evaluations and

performance reports. We reviewed the merit salary increases that the CLO awarded during 1995 and found that the merit increases were reasonable.

- **Ensure that the March 1994 reinstatement of its policy requiring the prior written authorization of overtime for nonexempt employees is followed and that the proposed form be amended to include the dates that overtime will be worked and the approval date.**

The CLO has reinstated the policy of requiring prior written authorization for overtime. Moreover, the CLO has controlled overtime costs to approximately \$5,000 for 1995. By contrast, in May 1994, we reported that the cost of overtime worked as a result of conservation and liquidation activities for 1993 exceeded \$350,000.

- **Investigate the propriety and recovery of all severance payments made by the division.**

The CLO no longer has any employment agreements that require severance payment. However, the CLO could not provide the legal opinions or accounting records to support the severance payments it made in September 1994 to employees who separated from its employment as a result of the closure of its Los Angeles office. Although nothing came to our attention that led us to believe the CLO should not have paid the severance benefits to the employees when they separated from employment, we could not determine the appropriateness of the payments to employees who separated as a result of the CLO's relocation to San Francisco.

- **Develop policies and procedures for the hiring of division employees that ensure that all qualified candidates have an opportunity to compete for job openings.**

The CLO has developed recruiting policies and procedures to ensure that all qualified candidates have an opportunity to compete for job openings. However, we found that the CLO did not always follow its policies and procedures when it hired at midpoint in the salary range an applicant who had three years' experience and did not possess a professional license to fill a position with minimum requirements of seven years' experience and a professional license. We reviewed its hiring policies and procedures and found that the CLO has established policies to post open positions internally and externally. In addition, the CLO has established specific job classifications and salary grades for those positions.

- **Ensure that future surveys conducted to adjust employee salaries include public-sector comparisons where appropriate.**

In September 1995, the CLO commissioned a new study of its salary scales to ensure the CLO remains competitive in the hiring and retention of personnel. This study also relied almost exclusively on comparisons of salaries paid in the private sector. According to the chief executive officer, the 1995 study included salary information from the State Workers' Compensation Insurance Fund. However, he also stated that the CLO's conservation and liquidation operations are unlike the public sector, and that public-sector comparisons are not valid.

- **Require consultants and outside law firms the division contracts with to submit detailed explanations or actual receipts with their claims for reimbursement for out-of-pocket expenses, or conduct audits of consultants' invoices to ensure that the consultants or law firms have not been paid more than what is due.**

The CLO and the department have created policies and procedures that require consultants and outside law firms to submit detailed invoices. However, we found that the CLO does not always monitor the contractors' billings to ensure charges for services are in compliance with the terms of the agreements.

- **Ensure that expenses identifiable to particular conserved or liquidated insurers are charged to those conserved or liquidated insurers.**

In our tests of direct and indirect costs charged to the estates the CLO manages, we did not identify any expenses identifiable to a particular conserved or liquidated insurer that the CLO charged incorrectly to another insurer.

- **Ensure that the time recorded by division employees on the cost allocation worksheet is accurate and agrees with the time reported by them on their time sheets for the period of allocation.**

The CLO could not support the time recorded to two of three allocation worksheets we reviewed. Specifically, the CLO used an incorrect number of direct labor hours from employee time sheets to allocate indirect variable costs. These errors affect the allocation of indirect variable costs

because the number of direct labor hours is the basis for allocation of indirect costs to each of the estates. In addition, the CLO allocates indirect fixed costs using an incorrect number of claims for each estate. The CLO estimates that it will take approximately three years to identify and correctly record the number of claims for all of the estates that it manages.

- **Ensure that the conserved and liquidated insurers that have borne a disproportionate share of past division expenses, particularly the expenses related to the cost of conserving and liquidating insurers with few assets, are reimbursed.**

The CLO received approximately \$432,000 from the Insurance Fund to reimburse conserved and liquidated insurers for their disproportionate share of past division expenses.

- **Secure funds to cover the ongoing costs of conserving and liquidating insurers with few or no assets.**

The CLO borrows from the investment pool it administers to fund the ongoing costs of conserving and liquidating insurers with few or no assets and seeks reimbursement from the Insurance Fund. We are concerned, however, because the CLO has overborrowed from the pool and has not repaid the pool in a timely manner. Because the CLO charges the Insurance Fund for the interest that accrues on the funds that it borrows from the pool, when it overborrows or does not repay the pool promptly, the Insurance Fund bears more cost than if the pool had been promptly reimbursed.

- **Ensure that qualified independent appraisers are used, whenever it is cost-effective, in the valuation of assets of liquidated companies before such assets are sold.**

We reviewed the CLO's policies and procedures, and a sample of its dispositions of insurers' assets, and found that the CLO has implemented a reasonable plan to select and use independent appraisers.

- **Ensure that division employees follow the newly developed policies and procedures in the disposition of assets that prohibit self-dealing and ensure that assets are sold at fair market value.**

We reviewed the CLO's disposition of the assets of liquidated insurers in 1995 and found the CLO solicited bids and used an independent auctioneer to conduct a public sale of the

assets. In addition, the CLO prohibited any party from purchasing assets who would give the appearance of self-dealing.

- **Ensure that there is proper segregation of duties in inventorying the assets of liquidated insurers, conducting the sales, and accounting for the receipts from the sales of liquidated insurers' assets.**

Under the supervision of the CLO administrative manager, a private auctioneer inventories the assets of liquidated insurers and conducts public sales.