
Program Review:
Department of Insurance
Insurance Examiner's
Fund

*Prepared for the Committee on Legislative Research
by the Oversight Division*

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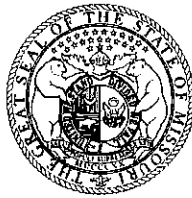
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October, 1997

Members of the General Assembly:

As authorized by Chapter 23, RSMo, the Committee on Legislative Research adopted a resolution in May, 1997 directing the Oversight Division to perform a program review of the Insurance Examiners' Fund which included the examination of records and procedures in the Department of Insurance to determine and evaluate program performance in accordance with program objectives, responsibilities, and duties as set forth by statute or regulation.

The accompanying report includes Oversight's comments on internal controls, compliance with legal requirements, management practices, program performance and related areas. We hope this information is helpful and can be used in a constructive manner for the betterment of the state program to which it relates.

Respectfully,

Harry Wiggins
 Senator Harry Wiggins, Chairman

Larry Thomason
 Representative Larry Thomason, Vice Chairman

EXECUTIVE SUMMARY

The Department of Insurance is charged with the responsibility of conducting financial and market conduct examinations of insurance companies doing business in the state. Currently there are 1804 licensed insurers in the state with 303 of them domiciled in Missouri. During the review period there were approximately 80 financial examinations and 36-55 market conduct examinations performed annually by DOI personnel. There are currently 78 full time positions funded out of the Insurance Examiners Fund. The costs of all examinations are billed to the companies being examined. Expenses incurred by the DOI and subsequent billed amounts received from the insurers are accounted for in the Insurance Examiners Fund. The General Assembly is to provide annual appropriations sufficient to distribute all receipts into the fund. Expenditures are roughly \$6-7 million annually.

Are DOI examination fees charged to insurers being correctly computed? Examination costs plus 15% for support and supervision should be billed to audited companies. Oversight interprets "examination costs" to be direct costs of examination such as field examiner salaries, fringe benefits and travel expenses. The DOI has taken a much broader interpretation to include indirect examination costs such as professional development for staff, computer support, annual leave time, audit manager time, and other operating expenses in billings as direct charges to companies under examination at the time. On top of those charges, DOI adds the 15% for supervision and support. Based on Oversight's interpretation of state law, the DOI overbilled insurers approximately \$1.4 million in FY95 and approximately \$1.5 million in FY96. For most companies these billings resulted in tax credits which were used to offset insurance premium tax liabilities. For nontaxable companies such as health maintenance organizations, farmers mutual companies and prepaid dental plans, the companies themselves incurred the expense of examination.


Are DOI's expenses reasonable resulting in efficiency in the examination process? By Oversight's calculations, DOI's total support and supervision costs equaled 33-34% annually. Since the state statute allows the DOI to charge insurance companies a 15% fee for these costs, and the fees were designed to fund the examination function, it would be reasonable to assume that the legislature intended for support and supervision expenses to fall within the 15%. Oversight recommends that the DOI either reduce their support and supervision expenses to 15% of direct examination costs or seek legislative action to raise the 15% fee. Regarding specific practices and procedures, Oversight noticed that the DOI allows examiners to utilize inefficient travel practices resulting in higher costs to examined companies and the state. Examiners routinely traveled alone in separate automobiles from the same city to an exam site, incurring duplicate and unnecessary mileage costs. The DOI cited employee moral and legal concerns as reasons for this practice, even though they had

a policy which contradicted such practice. Additionally, examiners domiciled in St. Louis had been assigned to exam sites in Kansas City, incurring not only mileage but lodging and meals when examiners domiciled in the same city could have performed the exam without the additional travel expenses.

Oversight recommends that the DOI conduct a study to determine the feasibility of contracting out the examination function to private companies versus utilizing state employees in order to determine the most cost effective approach.

This review includes detailed findings and recommendations for changes in management practices and procedures related to the Insurance Examiners Fund administered by the Department of Insurance. The Department's official responses to the findings and recommendations are incorporated into the report. Our review was performed in accordance with generally accepted government auditing standards as they relate to program and performance audits. We did not examine departmental financial statements and do not express an opinion on them.

We acknowledge the cooperation and assistance of staff of the Department of Insurance during the review process.


Jeanne Jarrett, CPA, CGFM
Director, Oversight Division

Introduction

The Joint Committee on Legislative Research directed the Oversight Division to conduct a program review of the Insurance Examiners Fund within the Department of Insurance (DOI). Legislation passed during the 1991 session established the Insurance Examiners Fund for the purpose of accounting for the costs of examinations of insurance companies performed by the DOI.

State law requires the DOI to conduct a financial examination of every insurer licensed in the state of Missouri at least once every five years and allows the DOI to conduct an examination as often as deemed appropriate. Statutes allow the DOI to accept a financial examination report on a foreign or alien insurer prepared by the insurance department of the company's state of domicile if that insurance department is accredited under the National Association of Insurance Commissioner's Financial Regulation Standards and Accreditation Program. In addition to financial examinations performed by the Division of Financial Regulation, the Division of Market Conduct performs market conduct examinations, which are primarily done as a result of consumer complaints. Financial examinations are performed on domestic companies in order to determine the financial condition of the companies and to enforce the rules and financial standards prescribed by Missouri statutes and the National Association of Insurance Commissioners (NAIC). Market conduct examinations may be performed on any licensed insurer in order to review the conduct of the insurer in the marketplace, including analysis of rate structures, review of policy rate applications, forms, endorsements and filings, and review of company practices and procedures for marketing, underwriting, rating and claims administration. Currently there are 1804 licensed insurers in the state with 303 of those domiciled in Missouri. During the review period the number of financial exams completed in any year was approximately 80, with the number of market conduct examinations completed in any year ranging from 36 to 55. The costs of all examinations are billed to the companies examined. Expenses incurred by the DOI and subsequent billed amounts received from the insurers are accounted for in the Insurance Examiners Fund. The General Assembly is to provide annual appropriations sufficient to distribute all receipts into the fund.

Background

Prior to establishment of the Insurance Examiners Fund effective July 1, 1992, examiners employed by the DOI billed companies directly for their time and travel expenses incurred during the exam, and companies paid the examiners directly. State law now provides that the DOI "shall assess the expenses of any examination against the company examined and shall order that the examination expenses be paid into the insurance examiners fund..." and "shall assess an additional amount equal to fifteen percent of the total expenses of examination, to be paid for the supervision and support of the examiners." The DOI is authorized to pay from the insurance examiners fund the compensation of examiners, any expenses to be paid from the sick leave fund (a fund that previously was used to pay for the salaries of examiners unable to work on an examination due to illness or injury and that was combined with the insurance examiners fund upon its creation), and expenses for supervision and support of the examiners. As required by statute, compensation of examiners is in accordance with applicable levels established by the National Association of Insurance Commissioners (NAIC). There are currently 78 full-time positions charged to the Insurance Examiners Fund.

With the creation of the Insurance Examiners Fund, the DOI also established a billing system for the purpose of producing monthly invoices to be submitted to the companies for payment. Information is entered into the billing system using time sheets and warrant requests to generate the invoices to the examined insurance companies. The invoices indicate the examiners working on-site, the number of hours spent on-site and current salaries, fringe benefits for the examiners, and travel expenses incurred during the month for the examination. In addition to these direct examination costs, certain other costs are prorated to all companies currently undergoing examinations and being billed by the DOI, and the 15% "supervision and support" fee provided for by statute is charged. State law provides that if any company refuses to pay its examination costs, it shall be liable for double the amount of such expenses as well as the costs of collection.

During the most recent three fiscal years, DOI collected examination fees and incurred expenditures to the Insurance Examiners Fund as follows:

	<u>Fees</u>	<u>Expenditures</u>
FY 1995	\$6,130,048	\$6,322,827
FY 1996	\$6,353,390	\$6,120,473
FY 1997	\$7,032,816	\$6,626,604

Although insurers are responsible for paying the examination fees assessed, Missouri is one of only four states that allows insurers to take a credit against their premium tax liability equal to 100% of their examination fees paid. Those insurers subject to premium tax and consequently eligible for tax credits include life, stock casualty, stock fire, mutual casualty, mutual fire, foreign fire, reciprocal, title, Missouri mutual and fair plan insurance companies. The first \$1 million in premiums collected by Missouri mutuals is tax-exempt. Those exempt from premium taxes and consequently ineligible for tax credits include health maintenance organizations, farmers mutual companies and prepaid dental plans. Premium taxes collected from most insurance companies are divided equally and deposited in the state's General Revenue Fund and County Foreign Insurance Tax Fund. Premium taxes collected from domestic stock insurance companies are deposited in the state's County Stock Insurance Fund. The amount of credits taken for three calendar years during the review period ranged from 40% to 55% of amounts billed as shown below:

	<u>1994</u>	<u>1995</u>	<u>1996</u>
Exam fees billed	\$5,778,573	\$6,443,626	\$6,746,397
Premium tax credits for exam fees	\$3,011,218	\$3,571,456	\$2,667,353

Since premium tax revenues are credited to the state's General Revenue Fund, the County Foreign Insurance Tax Fund, and the County Stock Insurance Fund, credits allowed would represent a loss to these funds.

Objectives

The primary focus of the review was to provide the General Assembly with information regarding the revenues and expenses of the Insurance Examiners Fund. Specifically, Oversight staff concentrated on three primary objectives:

- To determine whether examination fees charged to insurers were reasonable, necessary and based on true and accurate records of the actual costs of conducting such examinations.
- To determine if examination fees received were properly credited to the Insurance Examiners Fund and were expended appropriately.
- To determine if the Department of Insurance was using available resources in the most economical and efficient manner in regulating insurers.

Scope

The scope of the review focused on reviewing DOI's procedures for billing insurers for examination costs, reviewing the nature of financial examinations and market conduct examinations, and determining compliance with state laws regarding the required frequency of financial examinations. Staff reviewed activity in the Insurance Examiners Fund since its inception effective July 1, 1992. However, it should be noted that the DOI had discarded financial records for fiscal year 1993 since that year had been audited by the State Auditor's Office. Although documentation was obtained where possible from the Office of Administration, Division of Accounting, some supporting documentation for FY 1993 transactions was not available to Oversight.

Methodology

The Oversight Division conducted the review in accordance with Government Auditing Standards issued by the Comptroller General of the United States as those standards relate to program and performance audits. The methodology used by Oversight included evaluation of management controls to the extent necessary to fulfill objectives. A primary method used to measure objectives was conducting interviews with agency personnel. In addition, staff performed tests of controls through detailed testing of sample invoices submitted to insurers for payment and sample expenditures charged to the Insurance Examiners Fund. DOI provided information requested, including procedures manuals for financial and market conduct examinations, listings of examinations performed, program software for the billing system utilized accessible by Oversight in order to obtain detail supporting the invoices, and financial information for activity in the Insurance Examiners Fund. Surveys were sent to all other states in order to obtain information regarding those states' regulation and billing of insurers for examinations performed.

Findings

Recommendations

Agency Responses

FINDING #1:	Based on Oversight's calculation of supervision and support costs charged to the Insurance Examiners Fund, amounts are significantly higher than the 15% which is to be recouped according to state law.
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374.160 RSMo provides for the Department of Insurance to assess examination expenses to the companies examined plus an additional amount equal to 15% of total examination expenses for the supervision and support of examiners. It also states that examiner compensation, sick leave, and

expenses incurred for the support and supervision of the examiners are to be paid from the Insurance Examiners Fund. Consequently, statutory guidance provides that administrative expenses for the supervision and support of examiners should approximate 15%. However, the Department of Insurance charges supervision and support costs to the Insurance Examiners Fund in excess of 15% of direct examination costs. Based on Oversight's comparison of total expenditures of the fund to direct examination costs billed for fiscal years 1995 and 1996, the actual supervision and support expenses charged to the fund totalled 33% and 34% of direct examination costs, respectively.

RECOMMENDATION TO FINDING #1

The Department of Insurance should attempt to reduce administrative costs for supervision and support of examiners to 15% of direct examination costs. Consideration should be given to the nature of the costs charged to the Fund and whether another funding source for those expenditures would be appropriate. In addition, if the 15% supervision and support fee is not adequate to cover the actual support and supervision costs charged to the Insurance Examiners Fund, then consideration could be given to seeking legislative approval for increasing the additional fee to be charged for such items.

Agency Response to Finding #1

Department of Insurance:

The Department agrees that its charges to the insurance examiners fund significantly exceed 15% of "direct examination costs" as defined by Oversight. The Department notes, however, that 374.160, RSMo 1994, does not require the Department to assess insurers for "direct examination costs" plus 15% of "direct examination costs", but for "expenses of any examination and 15% of the total expenses of examination". As more fully explained in this agency's response to finding #2, "expenses of any examination" - the phrase used in 374.160, is not the same as the "direct examination costs" used by Oversight.

The Department disagrees with Oversight's recommendations. The Department's administrative costs comply with the requirements set forth in the statute. The Department has no need to seek an increase in the fifteen percent supervision and support assessments, because such fee is adequate

to meet the current needs of the Department based on its reasonable interpretation of 374.160 consistently applied since 1992. See Agency Response to Finding #2. The Department is, however, more than willing to work with the General Assembly if it believes the statute could be further clarified.

FINDING #2:	The Department has separately assessed charges for certain costs which should be covered by the 15% charge for "supervision and support," resulting in higher billings to insurance companies.
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Essentially the DOI bills examined insurance companies for three distinct groups of costs. In addition to direct exam costs (field examiner salaries, fringe benefits and travel expenses) and a 15% "supervision and support" fee allowed by state law, the DOI bills insurance companies for other indirect-type costs such as audit manager time and expenses, a computer specialist's time and expenses, in-house field examiner time and expenses, EDP costs, professional development costs, and other operating expenses. These expenses are prorated to all companies that are presently undergoing examinations and being billed for the month. The DOI considers these expenses to be costs of examinations; however, Oversight's interpretation of 374.160 RSMo is that these expenses should be funded by the 15% "supervision and support" fee and not billed in addition to the fee. Also, based on an analysis prepared by DOI which compares the amounts actually billed for the 15% fees to the actual expenses incurred by the DOI that are considered funded by this fee, the DOI has billed fees exceeding even what it considers to be costs chargeable to the 15% fee. The cumulative amount billed as 15% fees in excess of costs charged to this fee totalled \$388,477 as of June 30, 1997.

Based on Oversight's calculations, the amounts which the DOI billed insurers exceeded the amounts that would have been billed based on only direct examination costs plus the 15% fee by approximately \$1,431,059 in FY 1995 and approximately \$1,529,739 in FY 1996. Due to the fact that taxable insurance companies are offsetting their premium tax liability by the exam fees paid to the DOI, state revenue collections are reduced by amounts granted for credits. The state's General Revenue Fund, the County Foreign Insurance Tax Fund, and the County Stock Insurance Fund collections are

reduced by credits taken. In effect, the state bears the cost of these exams. For those companies not subject to premium tax and therefore ineligible for premium tax credits and to the extent that companies' exam fees exceed their premium tax liability, the companies themselves are incurring the expense.

RECOMMENDATION TO FINDING #2

The DOI should classify expenditures as either examination costs directly attributable to specific examinations or as supervision and support when billing insurance companies. Administrative costs for supervision and support should not be billed in addition to the 15% fee.

Agency Response to Finding #2

Department of Insurance:

The Department agrees that 374.160.3, RSMo 1994, authorizes and limits the Director's authority to make assessments of insurers for the insurance examiners fund to "examination expenses" and "an additional amount equal to fifteen percent of the total expenses of examination".

The Department also agrees that Missouri allows a credit against premium tax for examination expenses. Only three other states allow this credit. To give the reader some perspective, however, the Department notes that the credit for examination expense was just one of several such credits and deductions insurers take from their gross premium tax. In 1996 alone, the total of all such credits and deductions amounted to a loss of state revenue of more than thirty seven million dollars (\$37,000,000), of which examination fees were about \$2,900,000, or less than one-tenth the total. The Department would be a willing participant should the General Assembly wish to consider the continued propriety of the examination fee credit and other credits and deductions from premium tax.

The Department disagrees, however, with equating "total expenses of examination" under the statute to "direct exam costs". Instead, "total expenses of examination" as used in the statute also includes all expenses incurred for on-site examination.

The Department's position is supported by the opinion of its general counsel issued by memo dated July 16, 1992, when the Department was seeking

guidance on the proper interpretation of 374.160. The Department has acted consistently with that opinion since it was issued, with one possible minor exception noted later in this response. The Department's general counsel was the author of the language adopted by the general assembly in enacting 374.160 and 374.162.

In particular, Oversight asserts that the following expenses are not examination expenses but supervision and support expenses: (1) audit manager time and expenses, (2) a computer specialist's time and expenses, (3) in-house field examiner time and expenses, (4) EDP costs, (5) professional development costs, and (6) other operating expenses. With the possible exception of the computer specialist's time and expenses, the Department's treatment of the six listed expenses is consistent with both the language of 374.160 and the construction of that statute by the Department's general counsel per his July 16, 1992, memo.

Using the dichotomy posed in 374.160.3, the question is whether the item is an examination expense or a supervision and support expense, that is, is the expense directly attributable to the activities of the department in conducting an on-site examination of an insurer, or is the expense for the supervision and support of the on-site examiners? To answer this question, since June, 1992, the Department has consistently applied - with one possible minor exception - the primary purpose method recognized and approved by its general counsel, namely to examine each type of expense item and treat it according to whether its primary purpose is to serve on-site examination or supervision and support. In contrast, Oversight asserts that only "field examiner salaries, fringe benefits and travel expense", but none of the six expenses listed above, fall into the category of "expenses of examination". This assertion is inconsistent with the statutory language.

In addition, the Department's application of 374.160 is consistent with the legislative intent when the statute was enacted. The general counsel who drafted the legislative language actually adopted as 374.160 knew at the time of drafting, and department personnel at the time of legislative consideration and deliberation conveyed to members of the general assembly, that the statutory construction later set forth in the July 1992 memo would provide the Department not only with the means to continue its current level of examination activity but also the means to upgrade its financial monitoring processes in order to meet the National Association of Insurance Commissioners' financial standards accreditation requirements. In contrast, the position espoused by Oversight would have the affect of not

only imperiling the upgrading of financial monitoring processes, but also the current levels of examination activity.

Moreover, the percentages and dollar numbers used by Oversight to indicate its view of the extent of overbilling reconcile only if examiner's fringe benefits are excluded from direct exam costs. Fringe benefits are as much of an examiner's compensation as the examiner's wages. More importantly, Oversight expressly admits that fringe benefits are part of direct exam costs. Thus, the dollar numbers used by Oversight are inconsistent with its own stated methodology.

In contrast, the Department has consistently applied the primary purpose method as follows:

(1) audit manager time and expenses. Allocating audit managers' time and expenses to examination expenses is justified because the primary activity of audit managers is traveling to exam sites to help conduct the examinations.

(2) a computer specialist's time and expenses. When the Department originally created this position, the computer specialist spent more of his/her time traveling to exam sites helping the examiners interface with the insurers' computer systems, including mainframe computers. Over the years, however, the duties of the computer specialist have incrementally changed. Now, the computer specialist spends more of his/her time working on various examination-related projects in-house. Because the majority of a computer specialist's time and expenses are incurred in-house rather than on an insurer's premises during an on-site examination and are arguably in support the examiners' activity rather than an examination of the insurer's books, records, and accounts, a substantial possibility exists that these items should be considered within the 15% for supervision and support rather than examination expenses. The Department will reconsider this item.

(3) in-house field examiner time and expenses. This time spent in-house by field examiners and the expenses associated with that time are primarily related to the examinations currently being conducted by that field examiner and, therefore, are properly chargeable as examination expenses rather than as supervision and support.

(4) EDP costs. Oversight does not explain what it considers to be EDP costs. Because the computer specialist was addressed as a separate item, the Department believes Oversight intends to refer to the EDP costs associated with each on-site field examiner, such as the lap-top computers carried by the field examiners. If so, these expenses should be considered examination expenses inasmuch as these expenses are incurred directly for

the conduct of field examinations.

(5) professional development costs. Professional development costs for field examiners are examination expenses because they are incurred by field examiners whose activity consists of on-site examination of the insurers to which the professional development costs are billed.

(6) other operating expenses. Oversight does not define what it means by other operating expenses. Accordingly, the Department cannot make a specific response to this item.

Oversight also finds that the Department did not expend all funds collected as part of the fifteen percent (15%) statutory assessment. 374.160 and 374.162 do not, however, require the Department to expense all funds received into the insurance examiners fund. Moreover, the Department could not comply with such a requirement because of the timing differences between billing and receipts. Thus, the Department must attempt to err on the side of caution and bill the fund for slightly less than what the Department anticipates it will receive in order for the Department not to incur a deficit. Finally, operating a small but consistent surplus in the insurance examiners fund is sound management practice because incurred expenses must be paid from the insurance examiners fund, even if insurers which are indebted to the fund default.

In conclusion, the Department's billing practices, which are based on the recommendation of counsel made in 1992, represent a reasonable interpretation of 374.160 consistently applied.

Oversight's Comment:

In calculating the extent of overbilling, fringe benefits (taxes, insurance premiums and retirement contributions) for examiners were included by Oversight in direct examination costs. The only benefit not included was actual leave time taken by examiners. Furthermore, the terms "EDP" and "operating expenses" were terms extracted directly from Department of Insurance billings submitted to insurance companies. Oversight assumes that DOI has an understanding of what items they include in those categories. Oversight does not agree with DOI's "primary purpose method" of determining direct and indirect costs as described in their response.

FINDING #3: Contrary to state law, the Department of Insurance (DOI) accepts examination reports from another state that is <u>not</u> accredited by the National Association of Insurance Commissioners (NAIC) in lieu of performing examinations of companies domiciled in that state.
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RSMo 374.205 (3) allows the DOI to rely on other states' exams for foreign insurers in lieu of performing an examination of those foreign insurers if that state is accredited by the NAIC, if the examination is performed under the supervision of an accredited insurance department, or is performed with the participation of one or more examiners employed by an accredited state insurance department. The state of New York is not accredited by the NAIC due to the state's failure to adopt certain standards required by the NAIC. The state of Nevada has never been accredited by the NAIC. The DOI indicates that New York's insurance department is highly respected nationally, and therefore the DOI continues to rely on New York's exams in lieu of using additional resources on exams not considered priority. There are approximately 119 New York-domiciled insurers licensed in Missouri. There are no Nevada-domiciled insurers licensed in Missouri.

RECOMMENDATION TO FINDING #3

Oversight recommends that the DOI begin participating in examinations of New York companies licensed in Missouri in order to comply with state law, or seek legislative change possibly removing this requirement from state law. According to the NAIC, provisions for the acceptance of other states' examination reports only if those states are accredited is no longer a requirement for accreditation.

Agency Response to Finding #3

Department of Insurance:

The Department has accepted examination reports from another state which is not accredited by the NAIC. The Department also agrees that a remedy would be legislation removing this requirement from state law. The

Department's acceptance of such reports is, however, reasonable under the circumstances.

New York's Department of Insurance (DOI) has long been considered the leading insurance department in the United States. The NY DOI was accredited, but then was discredited simply because the NY legislature refused to pass a relatively minor accreditation standard. Published accounts indicated that the NY legislature did so to "send a message" to the NAIC that, in New York, the New York legislature makes the law, not the NAIC. Nothing has happened at the NY DOI to make it a less effective regulator today than when it was accredited. Further, the NY legislature adopted another law that required the NY DOI to retaliate against any other state that did seek to examine NY domestics simply because the NY DOI was discredited by the NAIC.

In light of these developments in NY, enforcing the Missouri statutory provision on NY domestics both would be an inefficient use of Department resources and would unreasonably burden Missouri insurers. Current Department resources do not allow the Department to examine a large number of NY domestic insurers. The Department would need to hire and develop a number of additional examiners as well as other positions and resources necessary to support this effort. This buildup of staff could quickly become unnecessary if the NY legislature adopted the statute required for the NY DOI to regain its accreditation.

Moreover, the NY domestics that write business in MO would be allowed to take a credit against their MO premium taxes for the costs of Missouri examinations. Thus, Missouri taxpayers would pay for this activity, not NY domestic insurers.

Additionally, since NY law now requires that the NY DOI retaliate against any state that does examine NY domestics because of the discreditation of the NY DOI, if the Department examined NY domestic insurers, the NY DOI would begin to conduct examination of MO domestics. This would add costs to the operations of Missouri domestics, thereby driving up costs to consumers or place Missouri domestics at a competitive disadvantage with insurers domiciled in other states.

The NAIC no longer maintains an Accreditation Standard that an accredited state automatically reject an examination report from another state for the sole reason that it has been discredited. The Department favors amending the existing Missouri statute in the next Legislative session to eliminate this out-dated Accreditation requirement.

FINDING #4:	The Department of Insurance (DOI) allows examiners to utilize inefficient travel practices resulting in higher costs to examined companies and the state of Missouri.
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The DOI does not require examiners to carpool when traveling to exam sites although the department's policy states that "employees traveling to the same location are expected to use available automobile space." In our sample of company invoices and supporting detail, we noted that in virtually all cases, examiners drove separately and were each reimbursed for mileage, despite arriving at and departing from the exam sites on the same dates. In one instance, three St. Louis examiners drove separately to and from a Chicago examination site. The DOI has also used non-domiciled examiners in locations where other examiners are domiciled. For example, on one Kansas City examination, three of the seven examiners assigned were from the St. Louis office, and all three were reimbursed for mileage for the same travel dates.

On an individual basis, examiners charge the least expensive mode of transportation to the exam site; however, since each examiner is reimbursed mileage for travel to the same location and on the same dates, costs to the insurance companies and to the state (when the companies are allowed premium tax credits to offset exam fees paid) are increased. This is especially the case when examiners from a different domicile travel to an exam site where other examiners are domiciled and each receives mileage reimbursement. In those cases additional lodging and meal costs are also incurred and billed to the companies. The DOI should utilize resources as efficiently as possible in order to minimize costs to insurers and to the state.

RECOMMENDATION TO FINDING #4

Oversight recommends that the Department enforce its policy regarding the use of available vehicle space by examiners and use examiners domiciled in the location of the examination site in order to minimize costs to the insurers and to the state.

Agency Response to Finding #4

Department of Insurance:

The Department agrees with Oversight that in general allowing examiners to use personal vehicles to travel to and from examination sites outside the examiners' official domicile is an inefficient travel practice. Reasonable explanations may, however, justify the use of personal vehicles in the examples cited by Oversight.

In one example, the Department intentionally assigned the three St. Louis examiners to the noted assignment in Kansas City. This particular company was very large and complex. It had operational features of certain companies that had become insolvent in the past. Because of the Department's concerns regarding this company, the Department decided to use operational features to conduct this particular examination. The resulting examination uncovered numerous statutory violations, less than conservative accounting procedures, and inadequate operational controls. As a result of the high quality of the examination, the company made proper corrections to its operations.

The other example cited by Oversight regarded examiners driving to job sites, although the Department's travel policy states that "employees traveling to the same location are expected to use available automobile space." Although this example may be in violation of this policy, the particular deviation may have been justified by the impact on employee morale and productivity. Perhaps an alternative to this example would have involved a rental vehicle rather than employees' automobiles.

Regardless of the justification for any particular example of inefficient travel practices, the Department in general agrees it should use the most efficient practice. The most efficient practice takes into account both the economics of the arrangement and the quality of the examination performed.

FINDING #5: The Department of Insurance (DOI) has not performed an analysis to determine if contracting out the examination process would be more cost-effective than the use of state employees.

The DOI should utilize resources as efficiently as possible in order to minimize costs to insurers and to the state. Oversight cannot conclude whether costs would be reduced if examinations were contracted out to private firms, since there is no cost analysis available comparing the two methods. Oversight's surveys of other states indicate that a variety of methods exist for regulating insurers—some states use only state employees, some use only contractors, and some use a mix of both to perform exams. Of the states that indicated some type of analysis has been done comparing costs under both methods, two indicated contracted costs were slightly higher, while two indicated contracted costs were less and one state indicated costs were substantially the same. None of the remaining 31 responding states had compiled any analysis to compare costs.

RECOMMENDATION TO FINDING #5

Oversight recommends that the Department consider performing a cost analysis for the purpose of comparing potential costs of contracting out the examination function to private companies versus utilizing state employees in order to determine the most cost effective approach.

Agency Response to Finding #5

Department of Insurance:

The Department agrees that it should perform a cost analysis of maintaining state employees as examiners versus contracting this function out to private entities.