



## Assessment Methodology and Process to Fund the Connecticut Insurance Department

### Background

In late May 2012, the program review committee authorized a review of how the assessment to fund the Connecticut Insurance Department (CID) is carried out. In late June, the committee approved a study scope that focuses on four areas:

- the way different categories of insurance companies are assessed to fund CID and its activities, as well as other state programs funded by insurance company assessments, and the amounts that result;
- the methodologies and mechanisms other states use to fund their insurance department activities, and the framework, basis, and process for any assessments or fees made in the various states;
- the trends in Connecticut in the number of insurance companies in the different assessment categories and the resulting amounts generated by category; and
- the scope and breadth of retaliatory tax laws and the implications of the treatment that Connecticut insurance companies might anticipate in other states if the methods of assessments were changed in Connecticut.

### Key Terms:

**Connecticut Insurance Fund:** This is a dedicated fund that supports primarily the Insurance Department, but also the Office of Healthcare Advocate and a program aimed at preventing falls (generally among the elderly) within the Department of Social Services. The Insurance Fund is supported through an annual assessment on Connecticut-based insurers. Payments are made quarterly.

**Retaliatory Tax:** Forty-nine states have enacted laws imposing a retaliatory tax. The laws essentially declare that the same taxes, fees, licenses or other requirements imposed on State A's insurers by State B will be imposed on State B's insurers when transacting business in State A. (Also could be described, less harshly, as reciprocity.)

### Main Points

**The insurance industry is an important segment of Connecticut's economy.** In FY 10, almost 61,000 jobs in the state were in the insurance industry, or about 5 percent of the total private sector jobs in Connecticut. Insurance carriers and related business contributed about \$23.8 billion to the state's economy, or 10.7 percent of the state's gross state product.

**Regulation of the insurance industry is concentrated heavily in the state where companies are domiciled** (i.e., home state, principal place of business). In FY 10, Connecticut had **109 insurance companies domiciled in the state, a rank of 24<sup>th</sup>**. However, some of the companies domiciled in Connecticut are the largest companies nationally.

**Connecticut is one of 30 states that has a dedicated insurance fund to support regulating the insurance industry, through an insurance department or division.** Of those, 18 states, including Connecticut, completely support the fund with fees and assessments on the regulated industry. Connecticut established this funding mechanism in 1980.

**The Insurance Fund is separate and distinct from the Insurance Guarantee Funds,** established in 1971, which protect consumers with claims against insurers who become insolvent. Assessments are made on insurance companies to support those Funds, but are offset by credits against premium tax liability.

**In FY 12, the Insurance Fund in Connecticut totaled \$26.6 million.** The bulk of that goes to fund the Connecticut Insurance Department (CID) – in FY 12 the CID budget was about \$24.3 million.

**Connecticut ranked 14<sup>th</sup> among the states for the overall budget (\$24.3 million) of its insurance department in FY 12.** When the department's budget is measured as a **ratio of direct premiums written in the state,** a National Association of Insurance Commissioners (NAIC) metric, **Connecticut ranks 23<sup>rd</sup> among the states and D.C.**

**There are myriad ways in which states assess insurance companies to fund their insurance departments.** Common funding mechanisms are flat dollar assessments per license, or sometimes on per-person or other unit basis. Assessments based as a percent of premiums written are also common. **Connecticut appears to be the only state that bases its assessment on companies in the same ratio as their state premium tax liability.**

Most states that use an assessment to fund the insurance department apply it to all insurers licensed in the state. **Connecticut and New York appear to be the only two states that apply the assessment to fund the Insurance Department on domestic insurers only.**

According to associations representing the insurance industry in Connecticut, the assessment on domestic companies only is financially beneficial to most Connecticut insurers who write extensively in other states because of the **Retaliatory Tax.** They indicate that applying the Connecticut fund assessment to all insurers would then require Connecticut insurers to pay other states' assessments in any of those states where they do business. But assessing only Connecticut insurers places a heavy burden on insurers that write premiums primarily in Connecticut and face heavy competition from nondomestic insurers in that line of business.

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# Insurance Department Funding Assessment Process

Study Update  
September 25, 2012

# Material in Update

- Background
  - Economic impact of insurance industry in CT
  - Industry Trends in CT – companies, premiums written, and taxes paid
  - Trends in Insurance Fund
- Assessment Basis and Mechanics
- Retaliatory Tax

# Background

- CT has 109 domestic insurance companies – 1.39% of all U.S. insurers
- But, because these companies are some of the largest in the country, their economic impact on the state is great:
  - In 2010, insurance carriers and related activity (not including financial services) contributed almost \$24 billion to state's economy or **10.7 percent of the state's gross state product**
  - In terms of **actual dollars (\$23.8 billion) to the state's economy, CT ranked 4<sup>th</sup> nationwide**
  - Only in much larger states – California, New York, and Illinois – did insurance make a greater dollar contribution to the state's economy
  - In terms of contribution of the **insurance sector to gross state product (10.7%) – CT ranked 1<sup>st</sup>**
  - In 2010, almost 61,000 jobs in Connecticut were in the insurance industry; or about 5 percent of all private sector employment

# CT Insurance Industry Trends

## Number of Companies

### Domestic Insurance Companies

#### 2001

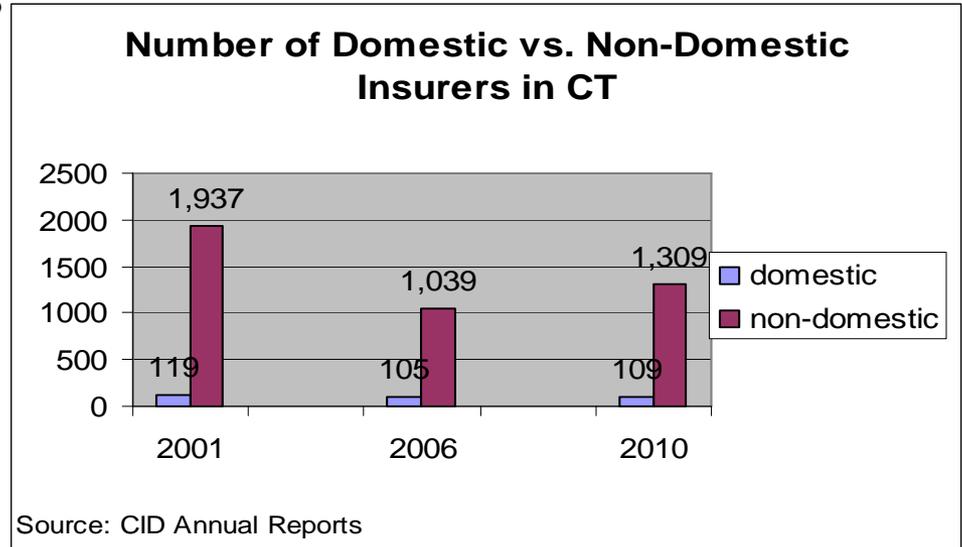
- 14 Health
- 72 Property/casualty
- 31 Life

#### 2006

- 10 Health
- 67 Property/casualty
- 26 Life

#### 2010

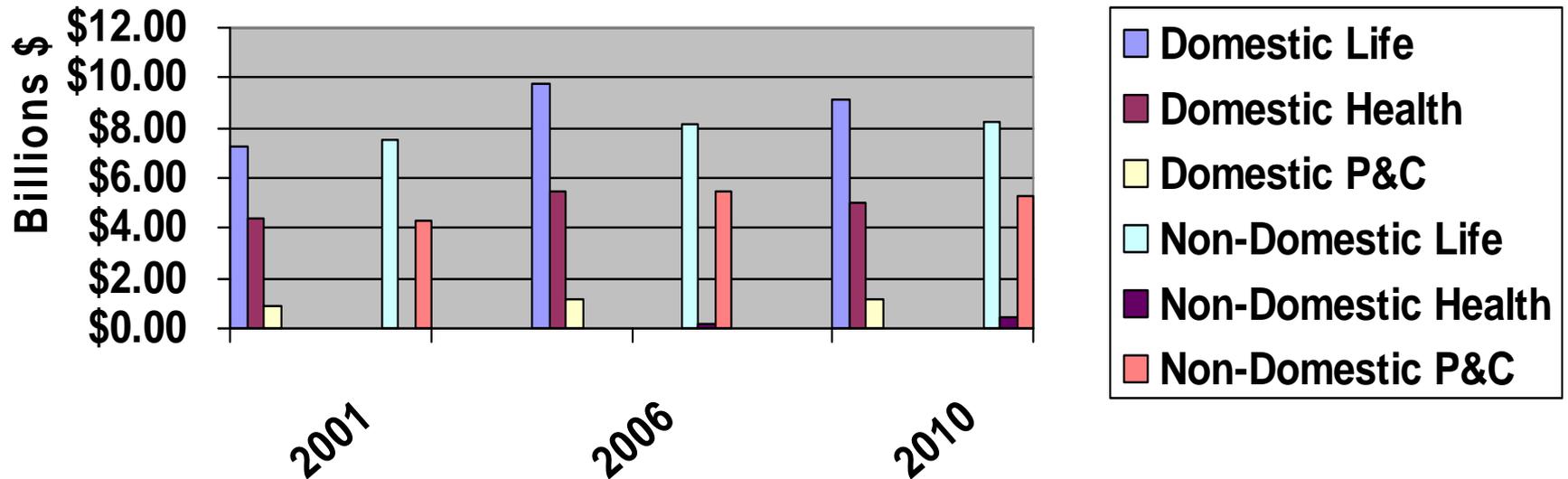
- 11 Health
- 71 Property/casualty
- 26 Life



## Background: Premiums Written in CT

<b>By Domestic Companies</b>	<b>By Non-Domestic Companies</b>
<b>2001</b>	<b>2001</b>
\$4.39 billion – Health \$7.23 billion – Life \$857 million – Property/Casualty	\$ 0 -- Health \$7.58 billion – Life \$4.34 billion – Property/casualty
<b>2006</b>	<b>2006</b>
\$5.49 billion – Health \$9.72 billion – Life \$1.16 billion – Property/Casualty	\$153 million- Health \$8.19 billion –Life \$5.44 billion –Property/Casualty
<b>2010</b>	<b>2010</b>
\$4.99 billion - Health \$9.16 billion - Life \$1.13 billion – Property/Casualty	\$460 million - Health \$8.28 billion – Life \$5.27 billion-Property/Casualty
Source: CID Annual Reports	

## CT Insurance Industry Trends: Premiums Written Domestic vs. Non-Domestic by Type



Source: CID Annual Reports

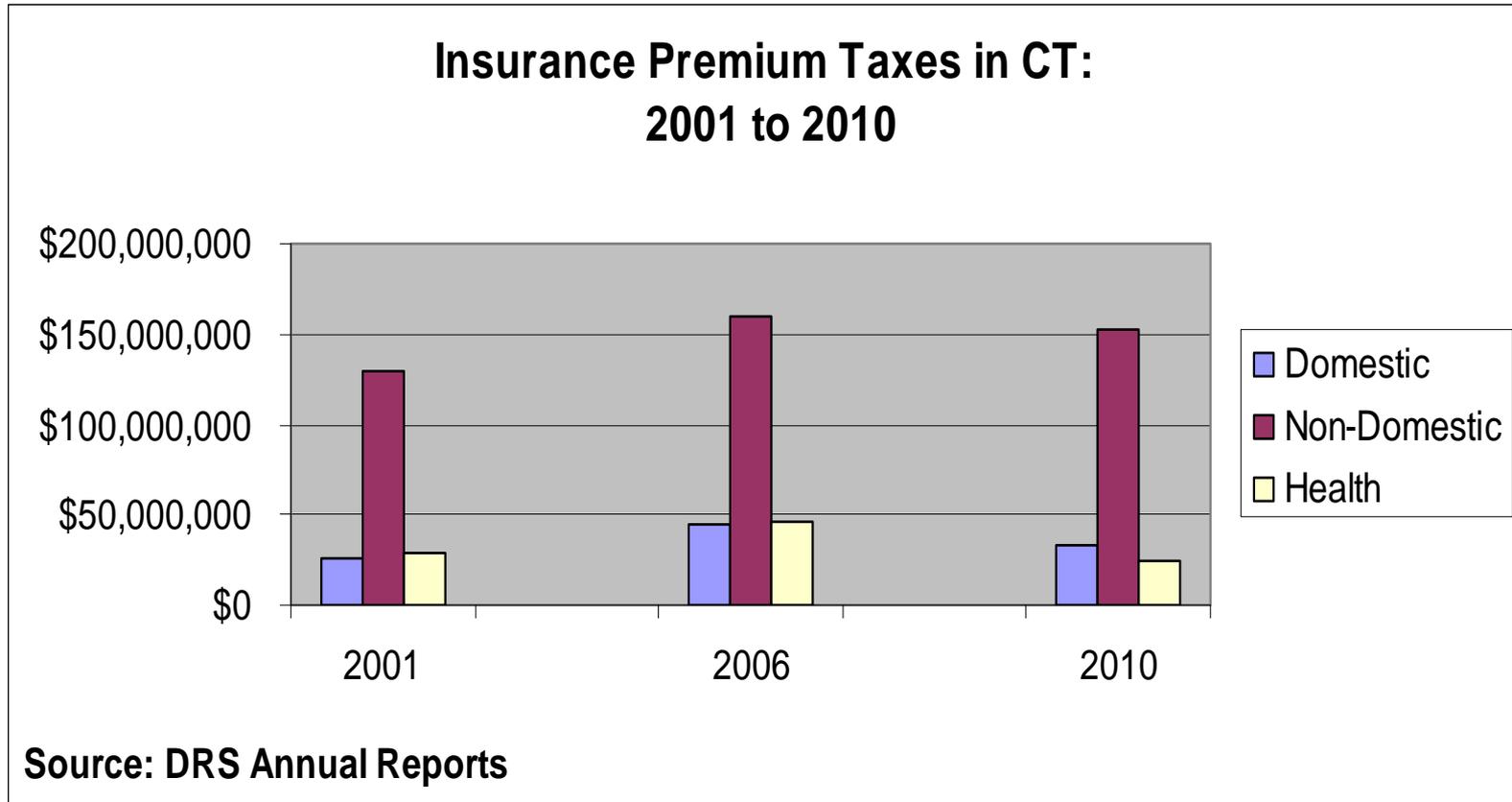
- Premiums written have declined from 2006 to 2010 for all categories, except non-Domestic property and casualty
- Non-Domestic property and casualty insurers write far more in premiums (\$5.27b) than domestic property and casualty insurers (\$1.13b) in 2010

# CT Insurance Industry Premium Taxes Paid

	2001	2006	2010	% Change 2001-2010
Domestic	\$26,332,115	\$44,241,863	\$33,017,215	+ 25.3%
Non-Domestic	\$129,879,387	\$160,253,745	\$152,140,265	+ 17.1%
Health (HMOs)	\$28,893,604	\$45,927,135	\$23,863,638	- 17.4 %
Source: CT Department of Revenue Services Annual Reports				

- Insurance premium taxes increased in all categories from 2001 to 2006
- From 2006 to 2010, premium taxes declined for the three groups
- Only for health care centers were premium taxes less in 2010 than they were almost a decade earlier, in 2001.

# Trends in Premium Tax



# Premium Taxes: Trends

Overall premium tax collections declined:

- Due to the economy

Premium taxes on health insurers have experienced even greater decrease because:

- More employers are self-insuring
- Connecticut's statutory exemptions to health insurance premiums (and subscriber charges) lessen the premium tax base:
  - Medicaid, Medicare, and Husky Plans
  - State Employee and Retiree Health Plans
  - Municipal Employees and Retiree Health Plans
  - Federal Employees Health Benefit Fund
- Office of Fiscal Analysis indicates these account for more than \$1.5 billion in premiums exempt from premium tax in FY 10

# Insurance Premium Tax Rate: State Comparison

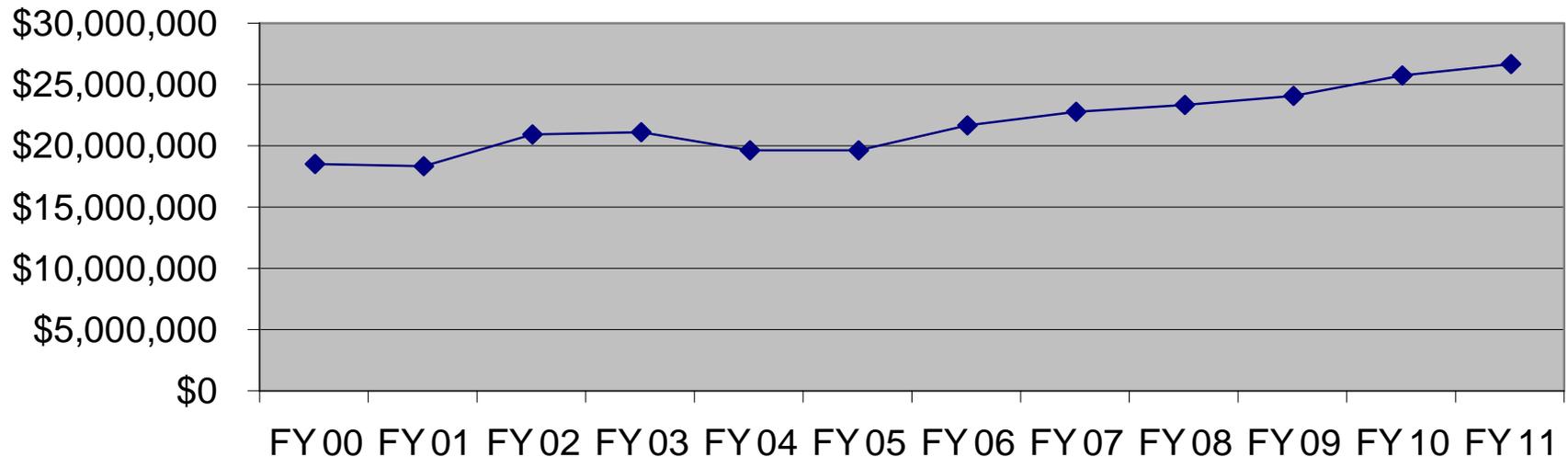
Tax Rate on Premiums Written in that State	States
Below 1%	WY
1%-1.74%	ID, IN, IO, MI, NE, NH, OH, SC, TX
<b>CT at 1.75%</b>	FL, IL*, ND
1.76% -2.00%	AZ, CO, DE, DC, KS, KY, ME, MD, MN, MO, NY, NC, PA, RI, VT, WA
Above 2% but less than 3%	AK, AR, CA, GA, MA, MT, NJ, OK, SD, TN, UT, VA, WI
3% or above	AL, HI, MS, NV, NM, WV

- Connecticut's insurance premium tax rate is competitive
- Only 10 states have lower and 3 other states tax premiums at that rate

Source: National Association of Insurance Commissioners Key Facts 2011  
 Illinois taxes income; effective insurance tax is 1.75%, Oregon appears to tax income and LA has extremely varied rates

# Connecticut Insurance Fund

## Insurance Fund Appropriations -- FY 00-FY 11

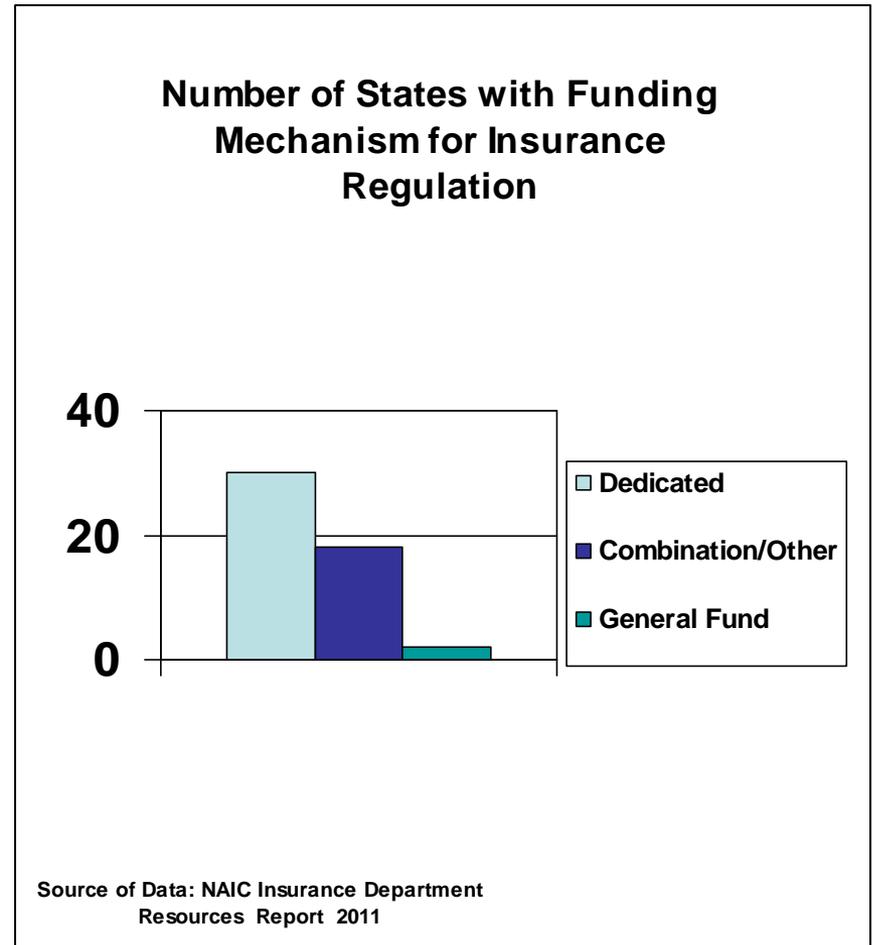


Source: OFA Budgets

- The Insurance Fund has increased about 44 percent over the 2000 to 2010 period; 23 percent since 2006
- But the premiums written, especially for domestic insurers, have not grown since 2006

# Type of Fund for Insurance Regulation

- Connecticut is one of 30 states and D.C. to have a dedicated fund for the agency that regulates insurance
- 24 states, including CT, use assessments and fees on the industry for 100% of the fund
- Only 2 states, Georgia and Pennsylvania, rely mostly on the General Fund to support insurance department



# Cost of Insurance Regulation

- In FY 10, the **CID budget** was slightly more than **\$23 million**; **CT ranked 14<sup>th</sup>** among all states and D.C.
- When the **CID budget is measured against direct premiums written in the state** -- a metric used by the National Association of Insurance Commissioners (NAIC), **CT ranks 23rd**
- It costs \$0.77 per \$1,000 of premiums written in Connecticut. This ratio ranges from a low of \$.18 in Delaware to a high of \$2.20 in Vermont.

# Assessments for Insurance Department

- In **CT**, **only domestic insurers are assessed** to fund the Insurance Department;
  - Connecticut and New York only states with assessments that assess just domestic insurers
- CT domestic **health insurers pay 20%** of Insurance Department expenses;
- **Other domestic** insurers pay **80%**;
- An individual insurer assessment is in the same proportion as the respective **premium taxes and charges** imposed on that Connecticut company;
- Connecticut appears to be the only state that ties assessments on premium taxes paid.

# Insurance Department Assessment

## **Special Provisions:**

### **Cap:**

- No one company can be charged more than 25% of expenses –
- Excess to be shared by all other companies in same ratio as overall assessment

### **Credit:**

- Companies may take a credit against their premium tax for 80% of Insurance Fund Assessment
- Eligibility for tax credit limited to companies with less than \$250 million in assets (smaller companies)
- Number of companies eligible for credit is decreasing:
  - 18 in 2001
  - 6 in 2010

# Insurance Fund Assessment

## **Mechanics:**

- Assessments are made on the same basis as proportion of premium taxes paid by domestic companies
- Department of Revenue Services provides that information to the Department of Insurance
- Department of Insurance issues assessments annually
- Payments are made quarterly
- Insurance Department deposits payments with State Treasurer – credited to the Insurance Fund

# Insurance Fund Assessment

## **Mechanics:**

- Annual assessment is made in August for:
  - Insurance Department including staff, fringe benefits, capital equipment and other expenses;
  - Office of Healthcare Advocate
  - DSS' Prevention of Falls Program (primarily for elderly)
- Less
  - Any balance in fund and reimbursements from non-domestic insurers for actual costs of examinations conducted on those companies the prior year.
- Companies may object to assessment in writing
- In 2011, annual assessments for individual companies ranged from less than \$100 (zero if they wrote no premiums) to more than \$2 million

# Retaliatory Tax

- Unique to insurance
- In existence since 19<sup>th</sup> century
- All states except Hawaii (4.265% tax rate) have a retaliatory tax
- Upheld by U.S Supreme Court

If State A takes any action affecting State B's insurance companies' ability to transact business in State A – increases taxes, imposes fees, and the like – State B will take similar action to companies from State A doing business in State B.

# Retaliatory Tax

- **Essentially says – you do that to our insurance companies, we will do that same thing to yours**
  - has a ripple affect
  - could raise revenue for the state
  - but puts a state’s domestic insurance companies at risk of higher taxes and fees in other states
- **Non-domestic insurance companies complete state insurance premium tax form using 2 computations:**
  - one calculates the tax obligations of state in which it is doing business
  - the other computation uses the tax obligations of company’s home state (retaliatory)
  - company pays the higher of the two

# Retaliatory Tax and the Assessment

- Because CT does not impose the assessment for the Insurance Department on non-domestic insurers, **CT insurers are currently not charged the assessment in other states**
- If CT were to impose the assessment on non-domestic insurers, then **CT companies would have to pay the assessments in all the other states in which CT insurers write premiums and fund through assessments**
- CT-based insurers that write significant premiums in other states indicate this will cost them more overall in other states than continuing to have the CT assessment shared only among domestic insurers
- But the current assessment application to only domestic insurers **does place a greater financial burden on those companies that write most of their premiums in Connecticut**, and face competition from other states' insurers in that line of business. In CT, this is particularly the case for property/ casualty insurance companies.

# Next Steps

- Focus on the last part of the study scope:
  - Financial implication of retaliatory tax on Connecticut companies in other states;
  - Determine if there are assessment methods that would make the burden on CT companies more equitable, without risking retaliatory action in other states; and
  - Make the assessment process less complicated and more transparent.