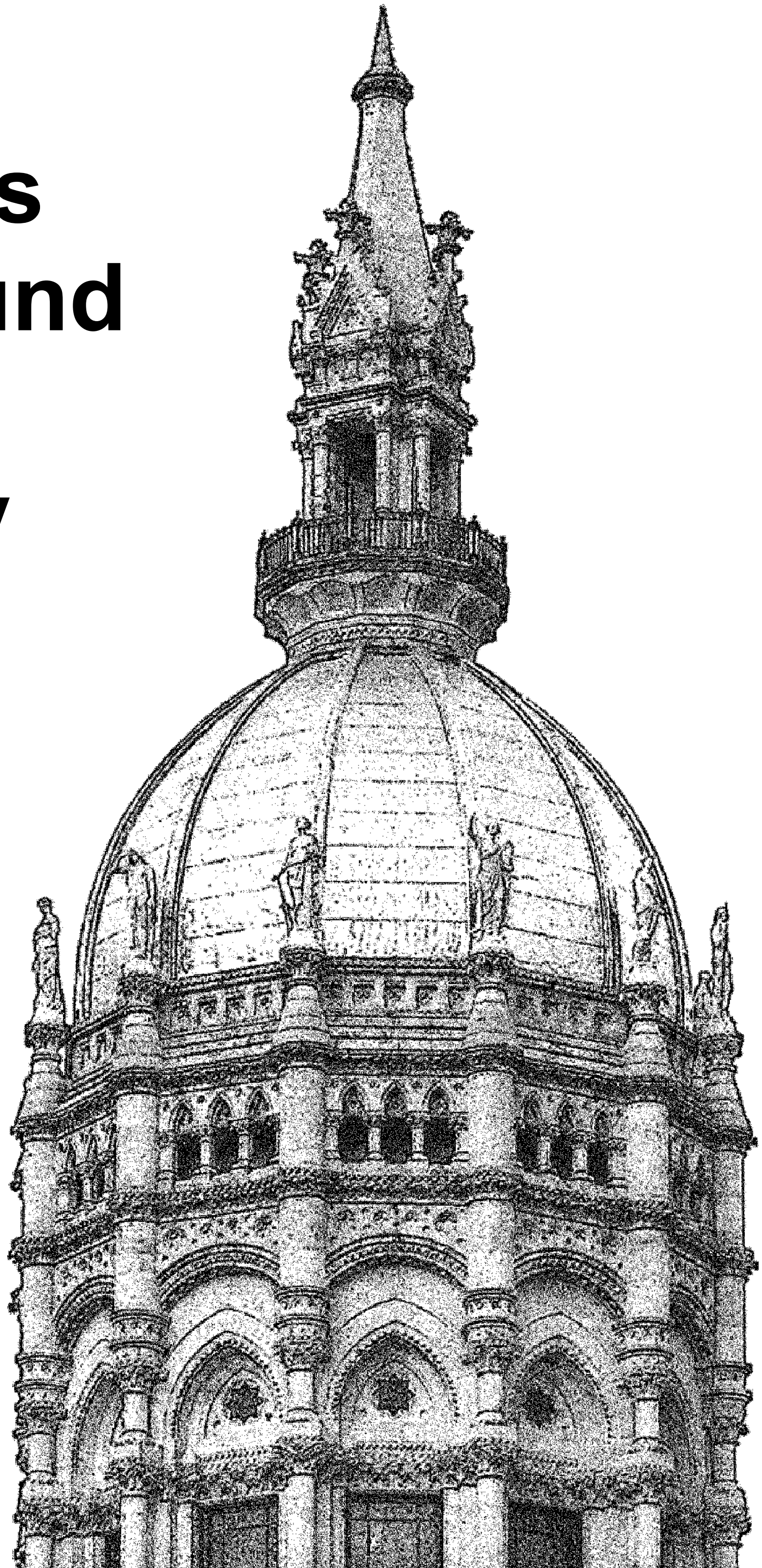
Connecticut's Insurance Fund Assessment Methodology

December 2012



PRI

Legislative Program Review and Investigations Committee

Connecticut General Assembly

CONNECTICUT GENERAL ASSEMBLY
LEGISLATIVE PROGRAM REVIEW AND INVESTIGATIONS COMMITTEE

The Legislative Program Review and Investigations Committee is a bipartisan statutory committee of the Connecticut General Assembly. It was established in 1972 to evaluate the efficiency, effectiveness, and statutory compliance of selected state agencies and programs, recommending remedies where needed. In 1975, the General Assembly expanded the committee's function to include investigations, and during the 1977 session added responsibility for "sunset" (automatic program termination) performance reviews. The committee was given authority to raise and report bills in 1985.

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LEGISLATIVE PROGRAM REVIEW
& INVESTIGATIONS COMMITTEE

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DECEMBER 2012

CONNECTICUT'S INSURANCE FUND ASSESSMENT METHODOLOGY

PRI Committee Report Highlights

December 2012

Assessment Methodology and Process to Fund the Connecticut Insurance Department

Background

In May 2012, the program review committee authorized a review of how the assessment to fund the Connecticut Insurance Department (CID) is carried out. In 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 insurers in the different assessment categories and the resulting amounts generated; 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 Findings

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. Thus, it is important that Connecticut provide a competitive environment for the insurers located here.

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, there were about 1,300 insurance nondomestic insurance companies licensed in Connecticut. Another **109 insurance companies were domiciled in the state.** Some of the companies domiciled in Connecticut are the largest companies nationally.

Connecticut is one of 30 states that have a dedicated insurance fund to support regulating the insurance industry, through an insurance department or division. Only two states, Connecticut and New York, assess only domestic insurers to fund their insurance departments.

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.**

Because the Insurance Fund assessment is made only on domestic insurers, it places a **heavy financial burden on insurers who write most of their premiums in Connecticut,** but who compete with much larger insurers (domestic and nondomestic) for business. Further, the assessment is not an accurate gauge of regulatory resources needed to oversee large insurers.

Billing and collecting from non-assessed companies. It was not clear that the Connecticut Insurance Department is vigorously implementing the statutory requirements that nondomestic companies and domestic companies that are not part of the Insurance Fund assessment are billed for actual costs and expenses for regulatory work the department performs for those companies.

PRI Committee Recommendations

- ***The Connecticut Insurance Department should vigorously bill and collect reimbursements for work performed in regulating non-assessed companies, list the regulatory work performed in assessment materials, and indicate how the reimbursements have lowered the overall amount that needs to be collected from domestic companies.***
- ***The Connecticut Insurance Department should annually provide that information to the General Assembly's Insurance and Real Estate Committee.***

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Introduction

Insurance Fund Assessment Methodology

Scope of Study

The committee undertook this study in late May 2012 after questions had been raised about the fairness of the way the Connecticut Insurance Department (CID) is funded, and equity of the assessment among companies doing business here. The committee approved the scope of study in late June, and incorporated several aspects including the way Connecticut funds the insurance department, the different categories of insurance companies and how they are assessed, and the basis and rationale for the assessments. The study focused on four areas:

- the way different categories of insurance companies are assessed to fund the 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.

Methods

The committee staff reviewed state statutes that mandate the assessment for the Insurance Fund as well as the methodology and process for how the assessment is implemented. Staff also examined budget documents to depict rends in the fund over the past decade. In addition, PRI also reviewed reports and materials compiled by the National Association of Insurance Commissioners (NAIC) on resources and funding of insurance regulatory agencies nationwide.

Committee staff also met with the Connecticut Insurance Department staff whose responsibility includes calculating and collecting the assessments, and reviewed the assessments for domestic companies for 2011. Committee staff also interviewed representatives of various insurance companies and their state associations.

The committee also held a public hearing on the study topic in September 2012, to hear testimony from various parties around the assessment methodology and its impact on Connecticut insurers.

Report Format

The report provides a profile of the insurance industry in Connecticut, including the number of domestic and non-domestic insurers, as well as the contributions the insurance industry makes to the state's economy. The report also describes the Connecticut Insurance Fund, what the trends have been in appropriations for the fund, as well as how the assessment process for the fund is implemented. Finally, the report contains findings and recommendations concerning the Insurance Fund assessment methodology. These were approved by the Legislative Program Review and Investigations Committee at its December 20, 2012, meeting.

Agency Response

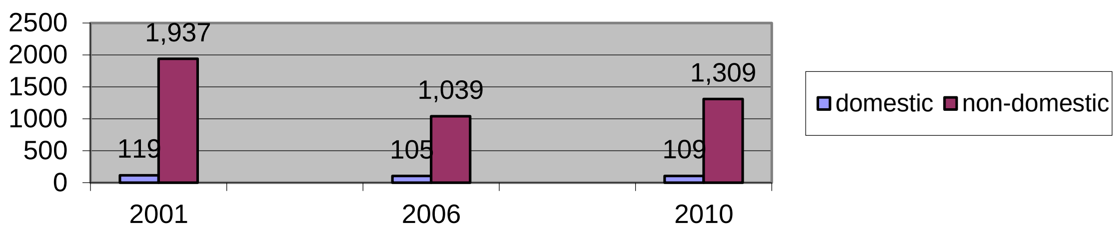
It is the policy of the program review committee to provide agencies included in the scope of the review with the opportunity to respond to the committee findings and recommendations prior to the publication of a study in final form. The Connecticut Insurance Department was sent a copy of the report for that purpose but chose not to comment.

Chapter I

Insurance Industry in Connecticut

As shown in Figure 1, there are about 1,400 insurers licensed to do business in Connecticut; 109 are domestic insurers, meaning Connecticut is their home state and principal place of business. Another 1,309 insurers are nondomestic companies.

Figure 1. Number of Domestic vs. Non-domestic Insurers in CT



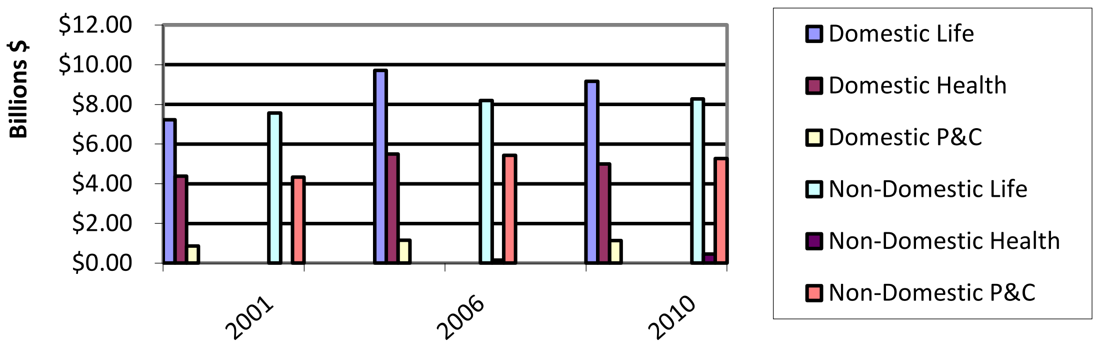
Source: CID Annual Reports

In FY 10, there were 61,000 jobs in Connecticut related to the insurance industry, or about 5 percent of all the private sector jobs in the state. Insurance carriers and related businesses contributed about $23.8 billion to the state's economy that year, placing Connecticut fourth nationwide in total dollar inputs. Only in much larger states, like California, New York, and Illinois, did the insurance industry make a greater dollar contribution. Further, as a percentage of Connecticut's gross state product, the insurance industry accounted for 10.7 percent, the highest in the country.

Premiums written. Figure 2 shows the trends in premiums written by category of insurer for three separate years over the past decade -- 2001, 2006, and 2010. As the figure shows, premiums have declined since 2006 in all categories, except for non-domestic life insurers, which increased slightly, from $8.19 billion to $8.27 billion.

As the graph shows, health insurance premiums are almost entirely written by domestic insurers (which include health maintenance organizations), with domestic companies writing almost $5 billion, while non-domestic insurers wrote about $460 million. In the property casualty area on the other hand, non-domestic insurers wrote $5.27 billion in premiums in 2010, almost five times the $1.13 billion written by domestic companies.

Figure 2. CT Insurance Industry Trends: Premiums Written Domestic vs. Non-Domestic by Type



Source: CID Annual Reports

Premium tax. Connecticut imposes an insurance premium tax on all insurers, both domestic and nondomestic. The rate in Connecticut is 1.75 percent of direct premiums written in that state. Table 1 shows the tax rate by category imposed by states nationwide. As the table illustrates, Connecticut's rate appears competitive, with only 10 states with lower rates, and three other states that impose the same 1.75 percent rate.

Table 1. Comparison of Insurance Premium Tax Rates Among States

Tax Rate on Premiums Written in that State	States
Below 1%	WY
1%-1.74%	ID, IN, IO, MI, NE, NH, OH, SC,TX
CT at 1.75%	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

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

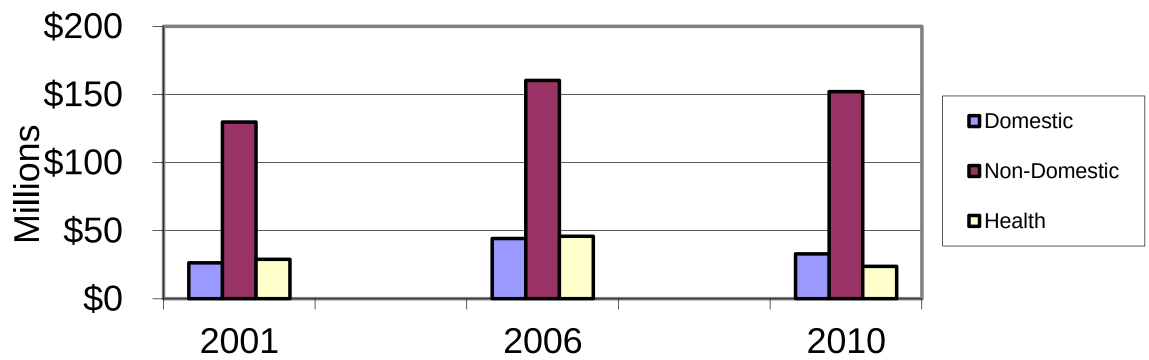
Table 2 and Figure 3 below provide data on premium tax trends in Connecticut for three selected years over the past decade – 2001, 2006, and 2010. As the table shows, premium taxes in all three categories have declined from 2006 to 2010, and premiums taxes in the health insurance area have dropped, even from 2001. Premium taxes overall have declined as insurance premiums written have decreased (Fig. 2) due to the poor economy. Also, premium taxes have waned because of the use of tax credits, especially the film tax credits, to reduce taxes paid.

As the table shows, declines in premium taxes for health insurance have been even greater, as an increasing number of employers either self-insure or discontinue offering health care coverage altogether. Also, Connecticut statutes allow a number of exemption to health insurance premiums (and subscriber charges to HMOs) that lessen the premium tax base. Those statutory exemptions include Medicaid, Medicare, and Husky Plans; state and municipal employee and retiree health plans, and federal employees' health benefit fund. According to the legislative Office of Fiscal Analysis, about $1.5 billion in premiums were exempt as a result of these provisions in FY 10.

Table 2. Connecticut Insurance Industry Premium Taxes Paid

Type of Insurer	Years			% Change 2001-2010
	2001	2006	2010	
Domestic	$26,332,115	$44,241,863	$33,017,215	+25.2%
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				

Figure 3. Insurance Premium Taxes in CT: 2001 to 2010



Source: DRS Annual Reports

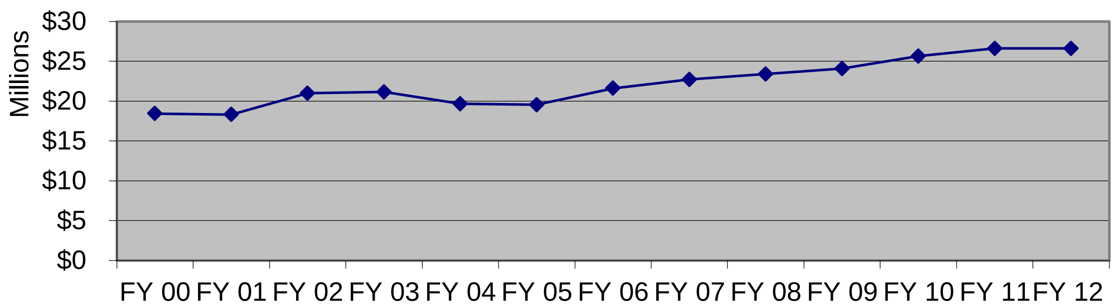
Insurance Fund

The insurance industry is primarily regulated by the states, rather than the federal government, and that oversight relies heavily on the regulatory entity in the state where companies are domiciled. Connecticut is one of 30 states that finance its insurance department through a dedicated insurance fund. Connecticut began its fund in 1980. Of the 30 states with a fund, 24 states, including Connecticut, completely support the fund with assessments on the regulated industry.

In FY 12, the Insurance Fund totaled $26.6 million, of which $24.3 million was to support the Connecticut Insurance Department (CID). The fund also finances all of the staffing and operating expenses of the Office of Healthcare Advocate, and a program in the Department of Social Services targeted at preventing falls among the elderly population. Figure 4 shows the Insurance Fund appropriations from FY 00 through FY 12. The amounts of the appropriations to the fund increased from $18.4 million at the beginning of the decade to $26.6 million in FY 12, an increase of 44 percent.

According to FY 11 comparative statistics compiled by the National Association of Insurance Commissioners (NAIC), the Connecticut Insurance Department's $24.2 million budget ranked 14th among all states.[1] However when the insurance department budget is measured against direct written premiums in the state, another metric used by NAIC, Connecticut drops to 23rd.

Figure 4. Insurance Fund Appropriations -- FY 00 - FY 12



Source: OFA Budgets

There are a myriad of ways that states use to assess the industry to support the regulatory agencies. Many states apply the assessment to direct written premiums in that state, while others assess on admitted assets, or flat dollar assessments per license or on a per-insured person basis. The vast majority of states that have an assessment specifically for funding the insurance department apply the charge to both domestic and nondomestic companies. Connecticut and New York are the only two states that apply the assessment only to domestic insurers.

[1] National Association of Insurance Commissioners, 2011 Insurance Department Resources Report, Volume 1, p.30.

In Connecticut, the assessment is made on domestic insurers in the same ratio as their premium tax liability (before use of credits, but after exemptions). Therefore, each year the Connecticut Insurance Department must request the state Department of Revenue Services to furnish CID with the information. After that information has been provided by DRS, the insurance department can calculate what each insurer's assessment will be of the overall Insurance Fund expenses, based on the same ratio each insurer has of the overall premium tax liability. The billing for the assessment is made annually, but payments are due quarterly. CID deposits payments with the State Treasurer, which are then credited to the Insurance Fund.

There is currently a cap on the assessment made to any one insurer. No one company may be charged more than 25 percent of the Insurance Fund overall expenses; with the excess shared by all the other companies in the same proportion as the overall assessment. There is also a credit that domestic insurers can take off their premium tax for 80 percent of their assessment of the fund. However, availability of the credit is limited to insurers with less than $250 million in admitted assets (i.e., smaller companies), and the number of companies that have been eligible to take the credit has declined from 18 in 2001 to six in 2010.

Findings and Recommendations

The PRI committee finds that the insurance industry is an important sector of the state's economy and there is an interest in ensuring the state cultivates a competitive environment for insurers located here.

As noted above, 30 states use a dedicated fund to support the agency or division that regulates the insurance industry. Almost all of those states assess both domestic and nondomestic insurers; New York and Connecticut are the only two states to assess only domestic insurers. However, applying the assessment to nondomestic insurers in this state would subject Connecticut insurers to that assessment in other states, through the retaliatory tax. This tax, which 49 states have implemented, essentially imposes the same taxes, fees, and licensing requirements on State A's insurers by State B as State B's insurers will incur when transacting business in State A. According to associations representing the insurance industry in Connecticut, applying the assessment to domestic insurers only is financially beneficial to most Connecticut insurers that write extensively in other states because of what is known as the retaliatory tax.

The PRI study determined that, because of the national presence of large insurers domiciled here, if the assessment were applied to domestic insurers for CID fund assessment, other states would retaliate and Connecticut insurers would incur a greater financial risk than would benefit the state overall. This would be especially true in states like California, with an Insurance Fund many times the size of Connecticut's, and where Connecticut companies write substantial business. Thus, the committee study concludes the Insurance Fund assessment should continue to apply only to domestic insurers.

However, at its September public hearing, the PRI committee heard testimony from representatives from one domestic company which believes it is bearing a disproportionate share of the assessment burden. Because this insurer writes most of its business in Connecticut, its assessment is based on that premium alone, yet must compete with insurers from other states with premiums written around the country. Those companies are not directly assessed for the CID's operating budget.

The PRI committee directed its staff at the hearing to try and develop an assessment methodology that would not put Connecticut domestic insurers at risk of paying the assessment in other states through the retaliatory tax, yet make the assessment methodology fairer for companies writing most of their premiums in Connecticut. To that end, the PRI staff proposed a change in the methodology and assessment base. However, the committee rejected that staff recommendation, concluding that there were too many unknowns about how the modifications would affect other Connecticut companies domiciled here. Further, the committee concluded that the staff-proposed changes to the methodology were too sweeping to correct a problem being experienced, or at least vocalized, by only one domestic company.

However, committee members agreed that another option -- expanding the premium tax credit for the certain companies to offset the insurance fund assessment -- was not prudent in these tight fiscal times. That option would place more of the burden on the General Fund rather than the insurance industry. The committee also acknowledged that, because of the confidentiality around use of tax credits by individual companies, it is difficult to determine which insurers might benefit from such tax credit expansion.

Instead, the committee suggested that during the 2013 legislative session efforts be made for parties to work together to develop an assessment threshold -- in addition to the overall cap already in place -- where no one company would pay an inordinate share of the assessment relative to its size or overall book of business.

Reimbursements and assessment reduction. The committee accepted the staff recommendation regarding more vigorous insurance department billing and collection for actual regulatory performed for companies that do not pay the insurance fund assessment. Connecticut statutes require that the actual costs and expenses of the regulatory examinations and reviews conducted of certain companies be billed to the companies and reimbursed to the department. The companies include nondomestic companies, and domestic companies who are not billed for the Insurance Fund assessments, including reinsurers, and fraternal benefit societies (Sec.38a-14h). The reimbursements are for actual work performed including market conduct reviews (C.G.S. Sec. 38a-15) examinations (Sec. 38a-49) and valuations of reserves (Sec. 38a-50). For the latter two examinations, the statute specifically lays out the calculation for staffing and other costs to be reimbursed.

It is not clear to PRI that CID is billing and collecting for all of the costs of such reviews and examinations being conducted. PRI staff obtained from CID billings for FY 12. The list showed seven nondomestic companies billed for market conduct reviews for a total of $290,552 and four companies, not subject to the Insurance Fund assessment, billed for financial examinations for $569,685.

However, PRI staff reviewed the list of completed market conduct reviews on the CID website, and found that there were an additional 63 market conduct reviews of nondomestic insurers completed during FY 12. It was not clear from looking at the reports the actual time CID examiners spent completing the reviews, and CID staff indicated that some of them require minimal time. However, even if the reviews took one reviewer one week -- at $80,000 mid-range salary -- that translates to $1,500 per review (without fringe). The listing of completed financial and reserves examinations is not up-to-date on the CID website, so PRI could not analyze the results of the billed amounts compared to all work done.

The reimbursed amounts from the nondomestic companies and otherwise non-assessed companies are required to be deposited to the Insurance Fund and accounted for as expenses recovered from insurance companies, and thus reduce the overall amount of the Insurance Fund assessments levied on domestic insurers. However, PRI finds it is not clear to what extent this is being done.

To address these concerns, the program review committee recommends:

- **The CID vigorously bill and collect reimbursements for actual work performed on non-assessed companies.**

- **The CID include a listing of all individual reviews and evaluations done involving non-assessed companies in the materials it distributes to domestic companies when it levies the assessment.**

- **Further, the assessment information should clearly show how those reimbursement amounts have been applied to the Insurance Fund, and hence the reduction in the overall amount that needs to be levied on assessed domestic companies.**

With this additional transparency, it should provide a greater level of assurance to domestic companies that the non-assessed companies are being charged for actual examinations and reviews done on those particular companies. Furthermore, it would make more public that the reimbursements are being accounted for and how the collections reduce the overall assessment amount.

In discussing the recommendation at the meeting on December 20, 2012, committee members indicated that the information on reimbursements and their impact on the assessment should also be provided to the legislative committee of cognizance. The PRI members conclude that this will ensure an additional level of accountability and oversight. Therefore the committee recommended that **this information should also be provided annually to the Insurance and Real Estate Committee of the Connecticut General Assembly.**