Findings and Recommendations

Connecticut Insurance Fund Assessment Methodology

Approved
December 20, 2012

Legislative Program Review
& Investigations Committee

CONNECTICUT GENERAL ASSEMBLY

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;

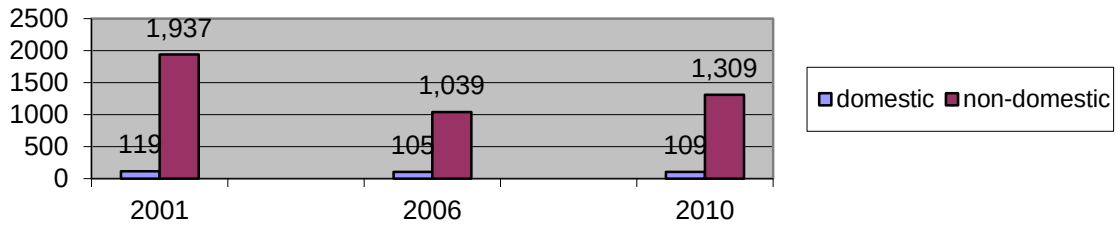
- the trends in Connecticut in the number of insurance companies in the different assessment categories and the resulting amounts generated by category; and

- 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.

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, or about 10.7 percent of Connecticut's gross state product.

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.

The CID budget ranked 14th among all states, according to FY 10 comparative statistics compiled by the National Association of Insurance Commissioners (NAIC). However, when the insurance department budget is measured against direct written premiums in the state, another metric used by NAIC, Connecticut drops to 23rd.

There are a myriad of ways that states use to assess the industry to support their funds. 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 per-insured person basis. The vast majority of states that have an assessment specifically for funding the insurance department apply it to both domestic and nondomestic companies. Connecticut and New York are the only two states that apply the assessment only to domestic insurers.

In Connecticut, the assessment is made on domestic insurers in the same ratio as their premium tax liability. 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.

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.**