



**A SPECIAL PERFORMANCE AUDIT
OF THE
INSURANCE DEPARTMENT**

***AUTOMOBILE, WORKERS' COMPENSATION,
AND HOMEOWNERS' INSURANCE***

SEPTEMBER 2010

Bureau of Departmental Audits

September 10, 2010

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania
225 Main Capitol Building
Harrisburg, PA 17120

Dear Governor Rendell:

This report contains the results of the Department of the Auditor General's special performance audit of the Pennsylvania Insurance Department (department) with regard to whether the department is adequately monitoring consumer complaints and the licensure of the insurers of automobile, workers' compensation, and homeowners' insurance. The audit covered the period July 1, 2002 through June 30, 2008, including follow-up procedures concluded as of April 5, 2010. This audit was conducted pursuant to Sections 402 and 403 of The Fiscal Code and in accordance with generally accepted government auditing standards (GAGAS). The aforementioned standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our auditors found that a lack of transparency exists within the department and that management should pursue changes to current law in order to afford greater transparency for taxpayers and policyholders. We asked management if it has ever proposed a change to the law or intends to do so in the future. Management indicated that there is no need to change the present law and expressed its belief that the department is transparent by following its current practices. Moreover, management indicated that supporting this type of action might eventually cause a run on insurance companies if there was any question about the solvency of such companies. We disagree with the department's position. Taxpayers have a right to decide whether they wish to change insurance companies or not and they need adequate information to make such an important decision.

Additionally, our auditors found that the department should improve its controls over the monitoring of consumer complaints. Based on our testing, we found that the department resolved consumer complaints timely and satisfactorily. In addition, hardcopy file information corresponded to database information. However, we noted certain concerns. Specifically, two consumer complaint case files out of 60 requested could not be located. Failing to locate and maintain complaint files could lead to the department not having the necessary documentation for subsequent follow up or inquiry. Moreover, the department's written policy lacks monitoring procedures and monitoring efforts are not documented and retained. Furthermore, the written policy of the department lacks a process for supervisors to review and approve case files.

We offer four recommendations to address identified deficiencies. We are confident that these recommendations, if implemented properly by management, will afford the public greater transparency relevant to the performance of the department while also strengthening the department's policies, controls, and oversight of insurance companies that conduct business in Pennsylvania.

We will follow up at the appropriate time to determine whether and to what extent the department has implemented our recommendations.

Sincerely,

JACK WAGNER
Auditor General

TABLE OF CONTENTS

	<u>Page</u>
<i>Results in Brief</i>	1
<i>Background</i>	3
<i>Audit Objectives, Scope, and Methodology</i>	6
<i>Finding No. 1 – The Insurance Department Should Pursue Changes to Current Law in Order to Afford Greater Transparency for Taxpayers and Policyholders</i>	8
Recommendations.....	12
<i>Finding No. 2 – The Department Needs to Improve Its Controls Over Monitoring Consumer Complaints</i>	13
Recommendations.....	14
<i>Department’s Response and Auditors’ Conclusions</i>	16
<i>Distribution List</i>	23



*Insurance Department
Automobile, Workers' Compensation, and Homeowners' Insurance*

*Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
September 2010*

***Results
In
Brief***

The Department of the Auditor General conducted a special performance audit of the Pennsylvania Insurance Department (department), focused whether the department is adequately monitoring the licensure of automobile insurers, workers' compensation insurers, and homeowners' insurers. The audit examined the period covering July 1, 2002 through June 30, 2008, including follow-up procedures concluded as of April 5, 2010. Our audit resulted in two findings and three recommendations, which we address in detail in the main body of this report.

Finding One

We discuss the department's need to pursue changes to current law in order to afford greater transparency for taxpayers and policyholders. One of the department's duties includes monitoring the financial condition (solvency) of approximately 300 licensed insurance companies domiciled in Pennsylvania. Management purports to be transparent, but it refused our auditors' request for documentation evidencing that the department properly monitored the solvency of these insurance companies, citing current law as the reason for doing so. We asked management if it has ever proposed a change to the law or intends to do so in the future. It indicated that there is no need to change the present law and expressed its belief that the department is transparent by following its current practices. Moreover, management indicated that supporting this type of action might eventually cause a run on insurance companies if there was any question about the solvency of such companies.

We disagree with the department's position. Taxpayers have a right to decide whether they wish to change insurance companies or not and they need adequate information to make such an important decision. In addition, as noted in our finding, we are aware of the information that the department makes available to the public on its website. However, this information falls short in that it does not enable our auditors to achieve their stated audit objectives.

We recommend that the department pursue changes to current law by requesting that the General Assembly amend the law as necessary to confer authorization upon the department to release all requested information and documentation when necessary for the Department of the Auditor General to adequately complete its audit objectives.

*Insurance Department
Automobile, Workers' Compensation, and Homeowners' Insurance*

*Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
September 2010*

Results in Brief

Finding Two

We discuss the need for the department to improve its controls over the monitoring of consumer complaints. Based on our testing, we found that the department resolved consumer complaints timely and satisfactorily. In addition, hard copy file information corresponded to database information. However, we noted certain concerns. Specifically, our auditors found that two consumer complaint case files out of 60 requested could not be located. Failing to locate and maintain complaint files could lead to not having the necessary documentation for subsequent follow up or inquiry. Moreover, the department's written policy lacks monitoring procedures and monitoring efforts are not documented and retained. Furthermore, the written policy of the department lacks a process for supervisors to review and approve case files.

We recommend that the department revise its consumer complaint policy to include written procedures to address monitoring activities of when, what, and how often procedures are to be performed, as well as what documentation is to be maintained to demonstrate that monitoring occurred. Moreover, we recommend that the department document a process for its supervisors to select and review a sample of consumer complaint files completed by investigators under their purview. This process should include a written sampling of methodology, procedures to follow when reviewing complaint files, and a requirement to sign or initial and date the file in order to demonstrate when the supervisor reviewed the complaint.

***Insurance Department
Automobile, Workers' Compensation, and Homeowners' Insurance***

*Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
September 2010*

Background The Insurance Department Act of 1921 resulted in the reorganization of the present-day Pennsylvania Insurance Department (department), after its creation in 1873.¹ The Governor's Executive Budget states that the department's mission is to serve Pennsylvania's insurance consumers through fair and efficient regulation of the insurance industry.²

The department has cabinet-level status within the executive branch of state government; therefore, the Governor of the Commonwealth appoints the state Insurance Commissioner (commissioner) to administer the agency. The Senate of Pennsylvania must confirm the appointment.

The department supervises the operations of approximately 1,700 insurance companies.³ Through the regulation of the insurance industry, the department works to ensure that proper protections are in place for Pennsylvania consumers of the various insurance products offered by insurance companies, products such as health insurance, life insurance, auto insurance, homeowners' insurance, and workers' compensation insurance. In order to fulfill its responsibilities, the department performs duties that include the licensing of insurance companies, agents, brokers, and bondsmen; the approval of rate and policy findings; and the administering of health insurance programs such as the Children's Health Insurance Plan (CHIP) for uninsured children and adultBasic for eligible adults who do not have health care coverage.

Additionally, the department coordinates the rehabilitation and liquidation of insolvent insurance companies; however, in an effort to curtail potential insolvencies, the department monitors the financial conditions and operations of insurance companies. Moreover, the department handles consumer complaints and inquires relevant to insurance companies and the products they offer.

Monitoring the Solvency of Insurance Companies

One of the department's primary duties, within the Office of Corporate and Financial Regulation, is monitoring the financial condition of licensed insurance companies domiciled in Pennsylvania. The department indicates that solvency regulation is one of its highest priorities because of the concerns with respect to the number of financially troubled insurers; therefore, the department continues to focus its resources on improving the effectiveness of regulatory actions in an attempt to rectify problems before insurance companies become

¹ *The Pennsylvania Manual*, Vol. 119, Section 4, p. 69.

² Commonwealth of Pennsylvania, *Governor's Executive Budget 2009-2010*, p. E25.1.

³ Commonwealth of Pennsylvania, *Governor's Executive Budget 2010-2011*, p. E25.6.

***Insurance Department
Automobile, Workers' Compensation, and Homeowners' Insurance***

*Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
September 2010*

Background

insolvent.⁴ Management emphasizes that the department conducts ongoing monitoring of insurance companies' solvency by periodically reviewing insurance company financial information and performing a financial examination of each insurance company at least once every five years.

Monitoring the Licensure of Insurance Companies

Consumers that purchase insurance products do so with the expectation that they are dealing with legitimate insurance companies that are financially sound. Consequently, the regulatory role of the department is important because it potentially offers consumers a protective mechanism against unscrupulous insurers or those that are in poor financial condition. Licensure acts a protective mechanism for consumers in that it is a standard of legitimacy for insurance companies doing business in Pennsylvania; it is illegal for unlicensed insurers to sell insurance. Therefore, depending on the type of insurance purchased, only consumers purchasing insurance from a licensed insurer will receive certain protections from loss, damage, or if a company becomes insolvent.

Licensed insurers provide an array of insurance products that provide specific types of coverage to consumers, including automobile, workers' compensation, and homeowners' insurance; our audit focused on the department's monitoring of the licensure of insurers that provide the aforementioned types of products. Consumers pay premiums with the expectation that an insurer will provide coverage when required by the consumer under the terms of the contract. With regard to automobile insurance, the Pennsylvania Department of Transportation can suspend a vehicle's registration and it may suspend a driver's license if the driver or owner of a vehicle does not maintain the required insurance. Consumers of homeowners' insurance products pay premiums to protect their structure and belongings in the case of loss or damage. An employer who hires at least one employee, part-time or full-time, is required to provide workers' compensation insurance, which the employer can purchase from an insurance company, or if eligible, the employer may opt to self-insure. An employer may be liable if an employee suffers an accident or incurs a job-related illness while at work.

⁴ Ibid, E25.6.

*Insurance Department
Automobile, Workers' Compensation, and Homeowners' Insurance*

*Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
September 2010*

Background

Consumer Complaints

The department also handles consumer complaints and inquires relevant to insurance companies and the products they offer. With regional offices located in Philadelphia, Pittsburgh, and Harrisburg, the Bureau of Consumer Services, within the department's Office of Market Regulations, is responsible for receiving all complaints on behalf of the department. In November 2005, the Bureau of Consumer Services began tracking complaints through a nationwide database used in the insurance industry.

For those consumers who wish to file a complaint, the department provides a standard form that consumers may submit online, through the mail, by fax, or in person at one of the regional offices listed at the bottom of the complaint form. The complaint form requires that a complainant provide his/her name and the name of the insured (if different from the complainant). The complainant must answer several questions, including the type of insurance relevant to the complaint, the type of problem, the name of the insurance company or agent/broker, and a brief description of the problem. The Bureau of Consumer Services either resolves the complaint or forwards it to another bureau/office within the department for assistance in resolving consumer complaints and identifying trends that may potentially affect a large number of consumers with similar complaints against an insurance company.

***Insurance Department
Automobile, Workers' Compensation, and Homeowners' Insurance***

*Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
September 2010*

***Objectives,
Scope, and
Methodology***

Objectives

The objectives of this special performance audit were to determine whether:

- the Insurance Department (department) is in compliance with applicable law and regulations regarding consumer complaints related to automobile, workers' compensation, and homeowners' insurance, and whether consumer complaints were resolved timely and satisfactorily (see Finding Two); and
- the department is adequately monitoring the licensure of automobile, workers' compensation, and homeowners' insurers (see Finding One regarding not being able to complete this objective).

Scope

Our audit covered the department's duties and responsibilities with regard to automobile, workers' compensation, and homeowners' insurance for the period July 1, 2002 through June 30, 2008, including follow-up procedures performed and concluded as of April 5, 2010.

Methodology

The methodology in support of the audit objectives included:

- reviewing appropriate statutes, regulations, department policy and procedure manuals, department budget, related information from the department's website, and newspaper articles;
- interviewing department management to gain an understanding as to how the department monitors the solvency of insurance companies domiciled in Pennsylvania. However, management refused to provide documentation in order for us to substantiate the procedures the department indicated that it performed to monitor insurance companies;
- interviewing department management and staff and reviewing documentation to assess controls and gain an understanding of policies and procedures used in processing and resolving consumer complaints; and

***Insurance Department
Automobile, Workers' Compensation, and Homeowners' Insurance***

*Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
September 2010*

Objectives, Scope, and Methodology

- using department data, we haphazardly selected a sample of 60 consumer complaint case files related to automobile, workers' compensation, and homeowners' insurance and reviewed them to determine whether the Bureau of Consumer Services resolved consumer complaints timely and satisfactorily.

*Insurance Department
Automobile, Workers' Compensation, and Homeowners' Insurance*

*Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
September 2010*

***Finding
One***

The Insurance Department Should Pursue Changes to Current Law in Order to Afford Greater Transparency for Taxpayers and Policyholders

According to the *Governor's Executive Budget 2009-2010*, "The mission of the Insurance Department is to serve Pennsylvania's insurance consumers through fair and efficient regulation of the insurance industry." Additionally, according to its website, the Insurance Department (department) ensures that insurance companies that sell and promote insurance products in Pennsylvania adhere to statutes and regulations. In order to achieve its mission and fulfill these responsibilities, one of the department's duties, within the Office of Corporate and Financial Regulation (office), includes monitoring the financial condition (solvency) of approximately 300 licensed insurance companies that are domiciled in Pennsylvania (insurance company). Additional related department duties include the licensing of insurance companies, agents, brokers, and bondsmen; approving rate and policy filings; and handling consumer complaints and inquiries.

As a result, we decided to focus on this area and determine whether the department is adequately monitoring the licensure of automobile insurers, workers' compensation insurers, and homeowners' insurers.

According to department management, the department conducts ongoing monitoring of insurance companies' solvency by periodically reviewing insurance company financial information and performing a financial examination of each insurance company at least once every five years. Department financial examiners perform a financial examination of insurance companies based on a risk-focused approach, which encompasses the assessment of various types of risks, including fraud risk, considering management controls, materiality, etc., and assists in determining the nature and extent of testing needed. The examiners use professional judgment to structure the examination. In addition, department financial analysts review financial information submitted by insurance companies on a quarterly and annual basis, including an annual audited financial statement report. The review of the audited report includes performing ratio analyses and other measures to gauge insurance companies' liquidity and solvency.

***Insurance Department
Automobile, Workers' Compensation, and Homeowners' Insurance***

*Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
September 2010*

Finding No. 1

Although management provided an explanation in general terms how its financial analysts and examiners monitor the insurance companies' solvency and the financial examination reports that reside on the department's website, we requested the following documentation to substantiate the procedures that the department performed to monitor insurance companies:

- Work papers of the quarterly and annual reviews of insurance companies' financial information, including financial analyses, ratios, comparisons, etc., and their results;
- Corrective actions taken by respective insurance companies as a result of findings in those reviews;
- Work papers of the five-year financial examinations performed on insurance companies, including procedures performed and conclusions reached;
- Completed examination programs which explain the procedures and steps performed by the examiners and reference to the applicable work papers; and
- Prioritized lists of insurance companies threatened by financial instability.

This information is necessary in order to perform an independent audit as to whether the department adequately monitors insurance companies on behalf of the Commonwealth taxpayer. We wanted to assure taxpayers that the department ensures that insurance companies are reputable and conduct business with integrity and without fraud. Auditing government programs provides an objective evaluation of the performance of government in order to hold departments accountable to taxpayers. It provides management with information that can be used to improve program performance, facilitate decision-making, and/or increase efficiencies.

***Insurance Department
Automobile, Workers' Compensation, and Homeowners' Insurance***

*Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
September 2010*

Finding No. 1

The department refused to provide the documentation and stated that it would be illegal to do so. Management cited specific provisions of The Insurance Department Act of 1921, as amended⁵ that the department maintains restrict it from providing documentation related to its monitoring of insurance companies: 40 P.S. § 323.5(f), which protects the documents underlying an examination report from disclosure to entities that are not insurance departments or law enforcement agencies; 40 P.S. § 443(d), which protects analyses regarding insurance companies' financial condition from disclosure except to the National Association of Insurance Commissioners; and 40 P.S. § 991.1407, which protects certain information and documents regarding insurance holding companies from disclosure to entities that are not insurance departments.

We asked management if it has ever proposed a change to the law or intends to do so in the future. It indicated that there is no need to change the present law and expressed its belief that the department is transparent by following its current practices. Moreover, management indicated that supporting this type of action might eventually cause a run on insurance companies if there was any question about the solvency of such companies. We disagree with the department's position. Taxpayers have a right to decide whether they wish to change insurance companies or not and they need adequate information to make such an important decision.

⁵ 40 P.S. § 1 *et seq.*

***Insurance Department
Automobile, Workers' Compensation, and Homeowners' Insurance***

*Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
September 2010*

Finding No. 1

The near-catastrophic recent collapse of the mutually supporting financial, housing, and insurance sectors further exemplifies the need for regulatory departments to reassure taxpayers, something the department faintly attempted to do with a press release⁶ in the wake of AIG International coming perilously close to financial ruin and requiring a bailout from taxpayers that reached \$123 billion by November 2008.⁷ The department's press release explained that the AIG group insurance companies in Pennsylvania, subsidiaries of AIG International, "are financially sound and their insurance policies are safe." It also asserted that the AIG insurance companies "are financially strong and their assets are protected by state regulators." The department made a point of distinguishing between the non-insurance AIG parent company and its AIG insurance subsidiaries by indicating that, because the insurance companies conduct business in Pennsylvania, the department subjects the insurance companies to rigorous investment, accounting, and capital adequacy standards. However, policyholders and taxpayers will never know the accuracy of these claims because the department cites current law with no intention to seek changes that would allow it to release pertinent documentation to the Department of the Auditor General, which only seeks to validate that the department is adequately monitoring the solvency of insurance companies.

By advocating and actively seeking changes in the law that would allow it to provide information requested by our auditors, and subsequently instituting any recommended corrective actions, the department would demonstrate that it is determined to enhance its supervisory oversight of an industry that is particularly unique in the industry's ability to survive economic hardship and profit substantially courtesy of policyholders and taxpayers.

Taxpayers have a right to know whether the department is adequately monitoring insurance companies, thereby protecting their assets and providing a sense of comfort and security to taxpayers, who pay insurance companies to do just that.

⁶ See *Insurance Department Assures AIG Policyholders*, September 24, 2008, Pennsylvania Insurance Department.

⁷ See *Timeline: AIG Developments Since U.S. Bailout*, March 15, 2009, Reuters, www.reuters.com/article/idUSN1529090920090316.

*Insurance Department
Automobile, Workers' Compensation, and Homeowners' Insurance*

*Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
September 2010*

Finding No. 1

Recommendation: We recommend that the department:

1. Pursue changes to current law by requesting that the General Assembly amend the law as necessary to confer authorization upon the department to release all requested information and documentation when necessary for the Department of the Auditor General to adequately complete its audit objectives.

*Insurance Department
Automobile, Workers' Compensation, and Homeowners' Insurance*

*Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
September 2010*

***Finding
Two***

***The Department Needs to Improve Its Controls Over Monitoring
Consumer Complaints***

The Pennsylvania Insurance Department (department) provides a standard form for consumers to use to submit complaints related to insurance matters. Complaints may be submitted online, through the mail, or in person at a regional office. The Bureau of Consumer Services, within the department's Office of Market Regulations, is responsible for receiving all complaints and either resolving the complaints or forwarding the complaints to another bureau/office within the department (i.e., Bureau of Licensing and Enforcement, Bureau of Market Conduct, Administrative Hearings Office) for their assistance in resolving consumer complaints and identifying trends which may potentially affect a large number of consumers with similar complaints against an insurance company/industry.

In November 2005, the Bureau of Consumer Services (bureau) began tracking complaints using the SIRCON Database (database), a nationwide database used in the insurance industry. According to database information provided by the department, the bureau processed more than 22,000 complaints related to automobile, workers' compensation, and homeowners' insurance from November 2005 through June 2008. Due to the bureau's policy that hard copy complaint files must be purged after two years unless otherwise marked, we selected 60 consumer complaints from a population of more than 10,000 complaints related to automobile, workers' compensation, and homeowners' insurance that were opened between March 3, 2007 and June 30, 2008. Based on our testing, we found that the bureau resolved consumer complaints timely and satisfactorily. In addition, hard copy file information corresponded to database information. However, we noted the following concerns that the bureau can improve upon:

- Two consumer complaint case files could not be located. Of the 60 complaints selected for review, the department did not provide two case files. According to the database, these two complaints were opened on May 22, 2007 and November 21, 2007, and, therefore, should have been retained. According to bureau management, these files could not be located. Failing to locate and maintain complaint files could lead to not having necessary documentation for subsequent follow up or inquiry.

***Insurance Department
Automobile, Workers' Compensation, and Homeowners' Insurance***

*Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
September 2010*

Finding No. 2

- Written policy lacks monitoring procedures and monitoring efforts are not documented and retained. Although bureau management indicated that monitoring procedures related to consumer complaints exist, these procedures are not documented and included in its policy and no evidence is maintained to substantiate that bureau management monitored the status of consumer complaints. According to management, aging reports are generated on a bi-weekly basis in order to monitor the timely resolution of complaints. The reports are used as a guide to discuss the status of the complaints with bureau investigators working on the complaints. However, once the discussion has taken place, the reports are disposed of and not retained. The reports, along with notes discussing these complaints, would provide evidence that monitoring is occurring. Failing to include monitoring procedures within its policy may result in management not monitoring consumer complaints or not effectively monitoring them on a regular basis.
- Written policy lacks a process for supervisors to review and approve case files. According to bureau management, not all case files are reviewed and approved by supervisors because of the volume of consumer complaints received. Instead, supervisors will only review case files when requested by the department's investigators or when selected for review through a random basis. However, the process of sampling and reviewing the case files is not documented. Additionally, management does not require the supervisor to sign or initial the case file to document that a review has occurred. Without these procedures in writing, the department has no way of ensuring that these reviews are adequately performed.

Recommendations: We recommend that the department:

2. Revise its consumer complaint policy to include written procedures to address monitoring activities of when, what, and how often procedures are to be performed, as well as what documentation is to be maintained to demonstrate that monitoring occurred;
3. Document a process for its supervisors to select and review a sample of consumer complaint files completed by investigators under their purview. This process should include a written sampling methodology, procedures to follow when reviewing complaint files, and a requirement to sign or initial and date the file to demonstrate when the supervisor reviewed the complaint; and

***Insurance Department
Automobile, Workers' Compensation, and Homeowners' Insurance***

*Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
September 2010*

Finding No. 2

4. Ensure that consumer complaint case files are maintained in accordance with the department's record retention policy.

*Insurance Department
Automobile, Workers' Compensation, and Homeowners' Insurance*

*Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
September 2010*

***Department's
Response
and Auditors'
Conclusions***

What follows on subsequent pages is the response of the Pennsylvania Insurance Department (department) to our findings and recommendations. The footnotes in this section are part of the department's response. Our auditors' conclusions follow each response submitted by the department.

We are confident that the recommendations that resulted from our findings, if fully implemented by management, will afford the public greater transparency with regard to the performance of the department while also strengthening the department's policies, controls, and oversight of insurance companies that conduct business in Pennsylvania.

Finding No. 1 – “The Insurance Department Should Pursue Changes to Current Law in Order to Afford Greater Transparency for Taxpayers and Policy Holders.”

Department’s Response:

The Insurance Department (Department) strongly disagrees with this finding.

It is clear from this finding that the Auditor General (AG) does not understand how the Pennsylvania Insurance Department operates and how insurance companies are regulated throughout the United States. The state based system of financial regulation of insurers is coordinated through the National Association of Insurance Commissioners (NAIC). It is based on each state regulator’s authority and ability to require insurance companies organized in that state to produce both public and non-public information. This information is prepared as required by comprehensive national accounting and reporting standards and shared with other state, federal and international agencies under consistent, specific statutory provisions. The state insurance regulatory system also sets detailed standards (NAIC Financial Regulation Standards and Accreditation Program) for how each state regulates the financial solvency of its domestic insurance companies to minimize the number and impact of insurance company insolvencies, promote inter-state cooperation and reduce regulatory redundancies. The Department’s current law is vital to its continued ability to perform in a national regulatory system designed to protect all insurance consumers.

The AG’s finding implies that there is little or no information readily available to the public. Under the existing state insurance regulatory system, the insurance industry is one of the most transparent industries in the world. Not only is there significant information available through the Department and the NAIC but the public also has the ability to review independent financial information and analysis on all insurance companies through A.M. Best¹. Insurance company information is required by state regulators to be available to the public includes annual and quarterly financial statements prepared in accordance with statutory accounting principles (NAIC statement blanks, instructions and Accounting Practices and Procedures Manual). Annual financial statements are comprehensive and detailed (well over 100 pages) and include an actuarial opinion on the adequacy of reserves being held for the payment of claims under insurance policies. The statements also disclose Risk Based Capital (RBC)² results. Other publicly available information are insurance company annual CPA audited financial reports, and reports of on-site financial and market conduct examinations conducted by the Department and other state insurance regulators. In addition, many insurance companies are part of publicly-held holding company systems which are subject to SEC filing requirements. SEC filings are publicly available. There is a great amount of information available to “taxpayers and policyholders” on all domestic insurance companies.

¹ A.M. Best Company is a credit rating organization dedicated to serving the financial services industries, including the insurance sector. Policyholders can refer to Best’s ratings and analysis as a means of assessing the financial strength of insurance companies.

² Risk based capital (RBC) is a uniform method for determining capital requirements based on the unique risks associated with the business operations of each insurance company. RBC is calculated by applying risk factors to specific aspects of an insurance company’s operations, including assets, liabilities or reserves and other business risks. The result of this risk analysis is then compared to the insurer’s actual capital. If an insurance company’s RBC results fall below specific levels, state law requires particular action on the part of the insurer or the Department, or both.

The NAIC state system of financial regulation of insurers is also transparent. Detailed guidance on how states are to conduct financial examinations and analyses (NAIC Financial Analysis and Financial Examination Handbooks) and detailed performance standards for state regulators (NAIC Financial Regulation Standards and Accreditation Program) were offered to the AG and are available on the NAIC website.³ Individual state NAIC accreditation status for compliance with the NAIC nationally approved and accepted standards is public information. Pennsylvania is NAIC accredited which indicates that Pennsylvania's financial oversight of domestic insurance companies meets these high standards set by the NAIC.

During the course of the audit, the Department worked with the NAIC to allow the AG access to the NAIC's accreditation report for its on-site review of Pennsylvania. The accreditation report is specifically the property of the NAIC and not the property of the Department. The AG would not agree to the confidentiality and use terms that the NAIC requires for release of its accreditation reports.

The Department is the primary state financial regulator of insurers domiciled in Pennsylvania for the protection of all (not just Pennsylvania) policyholders. Its responsibility to minimize the number and the impact of insurer insolvencies can only be accomplished if the Department has access to complete insurance company information. Without the benefit of Pennsylvania statute⁴ which protects confidential information vital to a regulator's understanding of an insurance company's financial condition, business operations and affairs, companies would not provide the open access to information that the Department currently enjoys. The purpose of this statutory protection, which exempts information even from subpoena, is to encourage the free exchange of information between the company and the regulator in order to maximize the effectiveness of examinations and ensure company solvency and compliance with law.

State insurance regulators, must rely on their ability to obtain and protect proprietary and in some cases information which could be considered "insider" information under state insurance laws and state or federal securities laws. Pennsylvania's statutory confidentiality protections which the AG recommends that the Department take action to change are consistent with NAIC national model law and the laws of all other 51 NAIC accredited jurisdictions (50 states and District of Columbia). As the AG correctly notes, Pennsylvania and other accredited jurisdictions have the statutory authority to share confidential information with other regulatory or law enforcement officials of any jurisdiction if the officials can demonstrate the authority and intent to protect its confidentiality. This is a vital tool for the Department and other state regulators in carrying out their responsibilities. This information sharing is carried out through the NAIC Master Sharing Agreement for state insurance regulators and agreements with other state, federal and international agencies.

³ There is a fee associated with procuring the NAIC handbooks.

⁴ 40 P.S. §§323.5(f) and 443(d) protect examination work papers and financial analyses work products from disclosure and even exempts them from court subpoenas.

During the course of the audit, the AG requested information that is strictly protected. The AG did not demonstrate to the Department or the NAIC its authority or even its intent to maintain confidentiality of this protected information. Disclosing the information requested to the AG without this authority and intent would jeopardize the Department's ability to continue to prevent disclosure of this protected information from other parties; and to obtain proprietary or confidential information from insurers, the NAIC, and other state, federal, or international agencies. It would also jeopardize Pennsylvania's current accreditation status with the NAIC.

The AG has recommended that the Department pursue changes to current law to release all requested information and documentation when necessary to the AG to complete its audit objectives.⁵ Such a statutory change would be counter to the U.S. state based system for regulation of insurance company financial solvency. It would jeopardize Pennsylvania's NAIC accreditation status. In effect, if such a statutory change was made, the Department would cease to be an effective or even viable state insurance regulator.

Auditors' Conclusion:

It is essential that we bring clarity to the response of the Pennsylvania Insurance Department (department) and not allow management's comments to obscure the intent of our audit by shifting the burden of its response onto a non-governmental entity. The Pennsylvania Insurance Department was the subject of our special performance audit and not the National Association of Insurance Commissioners (NAIC). Consequently, it is the sole responsibility of the department and not NAIC or any other entity to provide our auditors with the requisite information to satisfy our stated audit objectives.

Accordingly, because the department did not provide our auditors with specific documentation, we reiterate our conclusion that the department must immediately afford greater transparency for taxpayers and policyholders. Despite the department's expressed protestation of our finding, we can come to no other conclusion as long as management stands by its refusal to provide our auditors with pertinent documentation relevant to how the department monitors the solvency of insurance companies. It would be irresponsible for our auditors to accept the department's pronouncement of transparency, while it simultaneously denies our auditors the opportunity to gather and corroborate the requisite audit evidence.

Our auditors requested the aforementioned documentation, a list of which is contained in the finding, to substantiate the procedures that the department purportedly performs to monitor insurance companies. This information is necessary in order for our auditors to perform an independent audit. Department management refused to provide the documentation and stated that it would be illegal to do so, citing current law. In addition, as noted in our finding, we are aware of the information that the department makes available to the public on its website. However, this information falls short in that it does not enable our auditors to achieve their stated audit objectives. For that reason, our auditors explicitly requested the needed information and work papers from management.

⁵ The AG references two Department press releases concerning AIG. The AG made no reference to nor asked any questions concerning AIG during the audit. These comments were based solely on two department press releases. The AG made no effort to understand the facts concerning AIG. These comments are gratuitous and unfounded and should be deleted from the report.

We asked management if it has ever proposed a change to the law or if it intends to do so in the future. It indicated that there is no need to change the present law and expressed its belief that the department is transparent by following its current practices. Moreover, management indicated that supporting this type of action might eventually cause a run on insurance companies if there was any question about the solvency of such companies. We disagree with the department's position. Taxpayers have a right to decide whether they wish to change insurance companies or not and they need adequate and impartial information to make such an important decision.

Additionally, management referenced its accreditation under the Financial Regulation Standards and Accreditation Program administered by the National Association of Insurance Commissioners (NAIC). The membership of NAIC is comprised of the insurance commissioners or the chief insurance regulator of each state and territory, including the commissioner of the Pennsylvania Insurance Department. The department indicated that the transparency afforded by the NAIC should fulfill our auditors' inquiries about the performance of the department. However, we did not find this to be the case. In fact, our exchange with NAIC further heightened our concerns about transparency within the department.

On March 17, 2010, auditors and counsel from the Department of the Auditor General convened a conference call with counsel from NAIC to discuss NAIC releasing to our auditors its confidential five-year accreditation review report of the department. During the course of the conversation, we learned that the only information made public subsequent to an NAIC accreditation review is whether the state is accredited; therefore, NAIC informed us that this would be the only information about the department that our auditors would be able to include in our public report of the results of our special performance audit of the department. In addition, NAIC also told us that, before it would release any information about the department, we would be required to sign a confidentiality agreement signifying that we too would not make public any information about the department other than its accreditation status. We made the decision not to sign a confidentiality agreement because to do so would further deny the public access to pertinent information uncovered in the course of our audit. Moreover, we do not rely on external agencies to determine the relevance of requested audit evidence, thereby potentially influencing the outcome of our audit.

When we asked NAIC about which agencies and/or organizations it notifies upon discovery of major deficiencies such as fraud that it uncovers during an accreditation review of a state, NAIC representatives indicated that NAIC would report the finding back to the insurance commissioner of the respective state only and that no other reporting of the issue would be necessary. When asked if they would report the information to the public, NAIC representatives responded that they would not. Furthermore, one of our auditors mentioned to NAIC representatives about department management's concern that transparency will lead to a run on individual insurance companies in a time of crisis. Our auditor inquired as to the reason that NAIC "protects" the state by only disclosing the accreditation status of the state and none of the details uncovered during the accreditation review process. NAIC representatives responded by mentioning that the only information that outside parties need to know is whether the state is accredited or not accredited by the NAIC.

It is important to understand that, even if we had succeeded in obtaining a copy of the NAIC report, we would still have been deprived of access to other documents and information that the department claims is protected by state law.

The department remains emphatic that full disclosure relevant to the solvency of insurance companies does exist, even asserting in its response that, “the insurance industry is one of the most transparent industries in the world.” Conversely, our auditors found a lack of transparency, which has hindered our efforts to assure taxpayers that the department ensures that insurance companies are reputable and conduct business with integrity and without fraud. Taxpayers and policyholders will ultimately shoulder any financial burden stemming from poor oversight practices. Auditing government programs provides an objective evaluation of the performance of government in order to ensure accountability. We hope the department will reconsider its position and accept our recommendation.

Finally, with regard to the department’s contention that our reference of its public press release concerning AIG was unwarranted and/or unfounded, the department offered no tangible facts in its formal response demonstrating why it considered our mention of the department’s public announcement to be unnecessary. We believe our reference is appropriate.

Our finding and recommendations will remain as stated.

Finding No. 2 – “The Department Needs to Improve its Control Over Monitoring Consumer Complaints.”

Department’s Response:

The Department will take appropriate action to document its procedures and improve its monitoring of consumer complaints.

The AG noted that of the 60 complaints selected for review, the Department did not provide two case files. These files could not be located. The two files which could not be located were from the Pittsburgh Regional Office. The Pittsburgh Regional Office was closed in November 2009 and consolidated with the Central office (Harrisburg). As part of this consolidation, the Bureau of Consumer Services (Bureau) also simplified and streamlined its intake procedures. Now all documents and complaints come directly to the Central Office and are logged into the system. This will not only allow management greater oversight and control of complaint processing but will help to ensure that documents are kept in accordance with the Department’s record retention schedule.

The AG noted that the Bureau’s written policy lacks monitoring procedures. The Bureau does have monitoring procedures related to consumer complaints but these procedures are not documented. The Bureau acknowledges that these monitoring procedures are not in writing and will update its procedural manual to include written monitoring procedures.

The AG noted that written policy lacks a process for supervisors to review and approve case files. Not all case files are reviewed and approved by supervisors. This is due in part to volume and to the complexity of the complaints. Supervisors currently review and approve a random selection of case files, complex files and other files that the Bureau deems require supervisory review. The Bureau acknowledges that these monitoring procedures are not in writing and will update its procedural manual to include the current case file review and approval process.

Auditors’ Conclusion:

We commend the department for acknowledging that it needs to improve its controls over monitoring of consumer complaints. The department has indicated that it will take appropriate action to document its procedures and improve its monitoring of consumer complaints.

*Insurance Department
Automobile, Workers' Compensation, and Homeowners' Insurance*

*Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
September 2010*

Distribution List

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania
225 Capitol Building
Harrisburg, PA 17120

Ms. Sharon Anderson (4)
State Library of Pennsylvania
Serials Records Section
218 Forum Building
Harrisburg, PA 17120

The Honorable Robert L. Pratter (3)
Acting Insurance Commissioner
Pennsylvania Insurance Department
1326 Strawberry Square
Harrisburg, PA 17120

Mr. John J. Kaschak, Director
Bureau of Audits
Office of the Budget
8th Floor, Forum Place
555 Walnut Street
Harrisburg, PA 17101

The Honorable Robert M. McCord (2)
State Treasurer
129 Finance Building
Harrisburg, PA 17120

Mr. Phillip R. Durgin, Executive Director
Legislative Budget and Finance Committee
400 Finance Building
Harrisburg, PA 17120

The Honorable Donald L. Patterson
Inspector General
Executive House
101 South Second Street, 3rd Floor
Harrisburg, PA 17101

This report is a matter of public record. Copies of this report may be obtained from the Pennsylvania Department of the Auditor General, Office of Communications, 318 Finance Building, Harrisburg, PA 17120. If you have any questions regarding this report or any other matter, you may contact the Department of the Auditor General by accessing our website at www.auditorgen.state.pa.us.