



STATE OF ARIZONA  
OFFICE OF THE  
AUDITOR GENERAL

A PERFORMANCE AUDIT  
OF  
**THE ARIZONA  
DEPARTMENT OF INSURANCE**  
JULY 1979

QUARTERLY REMITTANCE OF INSURANCE PREMIUM TAXES TO THE STATE WOULD ENABLE THE STATE TREASURER TO INVEST THESE FUNDS SOONER AND EARN ADDITIONAL INTEREST INCOME. DURING 1979 THIS ADDITIONAL INCOME COULD HAVE BEEN AS MUCH AS \$1,660,000.

A REPORT TO THE  
ARIZONA STATE LEGISLATURE

REPORT 79-4





STATE OF ARIZONA  
OFFICE OF THE  
AUDITOR GENERAL

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July 27, 1979

The Honorable Bruce Babbitt, Governor  
Members of the Arizona Legislature  
John N. Trimble, Director of Insurance

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Arizona Department of Insurance. This report is in response to a September 19, 1978, resolution of the Joint Legislative Budget Committee and a January 18, 1979, resolution of the Joint Legislative Oversight Committee.

A summary of this report is found on the blue pages at the front of the report. A response to this report from the Director of Insurance is found on the yellow pages preceding the appendices.

Also, we have included for your information the results of our recently completed financial audit of the Department of Insurance.

My staff and I will be happy to meet with the appropriate legislative committees, individual legislators or other state officials to discuss or clarify any items in this report or to facilitate the implementation of the recommendations.

Respectfully submitted,

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## SUMMARY

The first Department of Insurance was created in 1913 and placed under the direction of the Arizona Corporation Commission. However, in 1968 voters approved a constitutional amendment creating an independent Department of Insurance. Article 15 section 5 of the Arizona State Constitution establishes the Department of Insurance as a constitutional entity charged with "...licensing, control and supervision..." of insurers.

The Department of Insurance has a staff of 58 full-time employees and is funded through the State General Fund.

Our review of the Department of Insurance showed the state could have earned more than \$1,660,000 in interest income in 1979 if premium taxes were collected as frequently as is done by other states. (page 13)

Our review also showed improvements are needed in the licensing procedures. The license processing time can be reduced by 23 days and licensing staff reduced by six positions if inefficiencies are eliminated. (page 18)

We found the Department's consumer complaint services are generally effective, but the public is largely unaware the services are available to help them. (page 33) Also, the Department has been ineffective in using data from consumer complaints to identify and regulate "problem" companies and agents. (page 36)

Greater Department action is needed with regard to consumer education and public interest. More needs to be done to develop consumer brochures and "readability" regulations should be enacted governing Life and Health insurance policies. (page 41)

Our audit found prior approval of most property-casualty insurance rates is not needed. Competitive rating laws work equally as well. Adopting such a law in Arizona would eliminate delays, questions of authority and the need for additional staff associated with the current prior approval law. (page 44)

Finally, greater statutory authority is needed for the Department to effectively regulate companies. Statutes governing unfair claims practices should be enacted and the director should be given authority to fine companies for violations of the insurance code. (page 62)

## INTRODUCTION AND BACKGROUND

In response to a September 19, 1978, resolution of the Joint Legislative Budget Committee and a January 18, 1979, resolution of the Joint Legislative Oversight Committee, the Office of the Auditor General has conducted a performance audit of the Department of Insurance. This performance audit was conducted as a part of the sunset review set forth in ARS 43-2351 through 43-2374.

Regulation of the insurance industry in Arizona preceded statehood with the passage of territorial laws relating to the insurance business. It was not until after statehood, however, that the first department of insurance was created. In 1913, the legislature created the Department of Insurance and placed it under the direction of the Corporation Commission.

The first Department of Insurance was staffed by a superintendent and three stenographers. In its initial year of operation the Department spent \$4,000, collected \$41,000 in taxes and fees, and supervised 147 foreign and seven domestic companies. Since 1913, both the insurance industry in Arizona and the Department of Insurance have grown. Now, sixty-five years later, the number of insurance companies licensed in Arizona has increased from 154 to more than 1,600. The Department has also grown to 58 full-time employees organized into seven divisions with an annual budget of \$1,091,715 as shown in the following table.

TABLE 1  
DEPARTMENT OF INSURANCE EXPENDITURES  
FOR FY 1977-78

Division	Employees		Expenditures										Total	% of Total
	Number	% of Total	Salaries	Benefits	Professional Services	In State	Travel Out of State	Other Operating	Capital Outlay	Other Operating	Capital Outlay	Total		
Director	2	3.5%	\$ 39,993	\$ 7,527		\$ 72	\$2,821	\$ 9,391	\$ 808	\$ 808	\$ 60,612	5.6%		
Hearing Division	2	3.5	37,138	5,784	\$14,797	114	570	6,202	1,325	1,325	65,930	6.0		
Property & Casualty Division	6	10.3	78,230	14,604	7,645	168	552	14,394	699	699	116,292	10.7		
Consumer Affairs Division														
Examiner	7	12.0	101,788	19,157	6,176	364	179	16,846	1,104	1,104	145,614	13.3		
Complaint	9	15.5	110,477	19,495	5,745	1,748		22,693	87	87	160,245	14.7		
License	12	20.7	109,575	16,750	33,578			28,823	679	679	189,405	17.4		
	28	48.2	321,840	55,402	45,499	2,112	179	68,362	1,870	1,870	495,264	45.4		
Life & Disability Division	8	13.8	109,110	20,342	8,006	42		19,145			156,645	14.3		
Administration Division	8	13.8	87,502	15,363				20,470	1,209	1,209	124,544	11.4		
Tucson Office	4	6.9	55,125	9,932	361	615		6,395			72,428	6.6		
Totals	58*	100.0%	\$728,938	\$128,954	\$76,308	\$3,123	\$4,122	\$144,359	\$5,911	\$5,911	\$1,091,715	100.0%		

\* This figure does not include 2.7 FTE seasonal positions.

The growth of the Department of Insurance and the number of insurance companies supervised led in 1968 to voter approval of a constitutional amendment creating an independent Department of Insurance. Legislation enacting Article 15, section 5 of the Arizona State Constitution removed the Department of Insurance from the direction of the Corporation Commission and established a separate department with its own objectives and functions.

The Department of Insurance has stated its objectives to be:

Administer the State insurance code to protect the citizens of Arizona who purchase insurance of all descriptions, and provide a better response to needs of Arizona insurance and related consumers.  
Stimulate the insurance market by encouraging competition.

To accomplish these objectives, the Department performs the following activities:

- tests and licenses agents, brokers, adjusters and solicitors
- reviews and approves insurers' initial and continuing qualifications to do business in the state
- approves property and casualty insurance rates
- approves life and disability insurance policy forms
- rehabilitates, supervises and/or liquidates insolvent insurers
- collects premium taxes and fees
- oversees the administration of the guaranty funds
- oversees the administration of the Joint Underwriting Plan for medical malpractice insurance
- investigates consumer complaints

The objectives of this audit were to:

- (a) Review the nine sunset factors to aid in the process of determining whether the Department of Insurance should be continued or terminated.
- (b) Determine whether the tax and audit functions are performed satisfactorily.
- (c) Determine whether the licensing process is efficient and timely.
- (d) Determine if consumer complaint services are effective in handling complaints and assisting the public.
- (e) Determine whether the Department of Insurance's actions are satisfactory with regard to consumer education and public involvement.
- (f) Review the need for prior approval of property-casualty rates.
- (g) Review the need for additional legislation to enable the Department to fulfill its regulatory role.
- (h) Review and report other pertinent information of value to the Legislature.

The Office of the Auditor General expresses its gratitude to the Director of the Department of Insurance and his staff for their cooperation, assistance and consideration during the course of the audit.



SUNSET FACTORS

In accordance with ARS 43-2351 through ARS 43-2374, nine factors were reviewed to aid in the process of determining whether the Department of Insurance should be continued or terminated.\*

SUNSET FACTOR: OBJECTIVE AND PURPOSE  
IN ESTABLISHING THE DEPARTMENT

Article 15, section 5 of the Arizona State Constitution provides that "Domestic and foreign insurers shall be subject to licensing, control and supervision by a department of insurance as prescribed by law." (emphasis added) Title 20 of the Arizona Revised Statutes provides the Department with authority to: license companies, license agents, approve life and disability insurance policies and advertising used in the state, approve property-casualty rates, conduct examinations and investigations and collect premium taxes and fees.

The Insurance Department has stated its objectives to be:

"Administer the State insurance code to protect the citizens of Arizona who purchase insurance of all descriptions, and provide a better response to the needs of Arizona insurance and related consumers. Stimulate the insurance market by encouraging competition."

SUNSET FACTOR: THE DEGREE TO WHICH  
THE DEPARTMENT HAS BEEN ABLE TO  
RESPOND TO THE NEEDS OF THE PUBLIC  
AND THE EFFICIENCY WITH WHICH IT HAS OPERATED

The Department has responded to the public need when such need has become evident. For example, the Department is currently developing Medicare supplement regulations in response to a growing problem with elderly consumers being sold excessive numbers of this type of policy. The Department has also developed rules prohibiting insurance companies from denying benefits or coverage on the basis of sex or marital status. However, when compared with some other states, the Department could do more to encourage public input on insurance needs. (page 42)

\* Because the Department of Insurance is created by the State constitution, a constitutional amendment will be required should a decision be reached to terminate the Department. Such an amendment procedure was provided for in SB1313 which was passed by the 1979 session of the Legislature.

Our review of the Department's operations revealed the following opportunities exist to improve the Department's level of efficiency.

- The licensing processes of the Department cause unnecessary delays in issuing licenses and the licensing staff is excessive. (page 18)
- The prior approval by the Department of insurance rates charged for auto, homeowner, fire and other forms of property and casualty insurance causes long delays, procedural problems, and an unnecessary utilization of staff resources. (page 44)
- The number of formal Department hearings can be significantly reduced without impairing the Department's ability to obtain necessary information. (page 65)

SUNSET FACTOR: THE EXTENT TO WHICH  
THE DEPARTMENT HAS OPERATED WITHIN  
THE PUBLIC INTEREST

Essentially, all of the Department's activities appear to be in the public interest. Many of the Department's practices such as reviewing policies to make sure provisions are not misleading, licensing agents to ensure agents have basic knowledge of insurance laws, processing consumer complaints, and examining the market conduct of companies are definitely in the public interest. Our audit revealed that the policy review functions and market conduct examinations are effective in protecting the public interest.

Policy Review - The Life and Disability Division approves all policy forms and advertising used in selling life, disability (accident and health), and credit insurance in Arizona. This is done under the authority of ARS 20-1111 which requires the Department to disapprove the use of any policy which contains any "...inconsistent, ambiguous or misleading clauses..." Policies must also be disapproved if they fail to contain specific standard provisions required by law. In addition, policies may be disapproved if "...false, deceptive or misleading..." advertising is used to sell the policies.

According to experts, Arizona's policy review function is effective. Attorneys for the Health Insurance Association of America and the American Council of Life Insurance (who are familiar with policy review functions throughout the country) stated that Arizona is effective in its policy review. Arizona attorneys who specialize in insurance law stated that the policy review was effective; and two such attorneys stated that the function probably helped minimize litigation over insurance contract terms.

The Department's complaint investigators stated that they were unaware of any insurance contract provisions that were not caught in review that were causing consumer complaints. In addition, the Supervisor of the section stated that the review and approval of advertising for policies was one reason the Department received only five complaints about misleading advertising during 1978.

Market Conduct Examinations - Market conduct examinations investigate company treatment of policyholders in such areas as: sales and advertising, underwriting, rating practices and claims handling. The department performs the market conduct examinations both in conjunction with regular financial examinations and as special, separate examinations. We found market conduct examinations are effective in identifying and correcting problems. The seven special market conduct examinations performed in the last two years identified numerous problems, most of which were rapidly resolved following the examinations. Examples of problems identified include:

- use of policies with provisions that violate State law
- failure to pay proper interest and dividends
- excessive premiums charged for policies
- delayed payment of claims
- noncompliance with rate approval requirements of the Department
- underpayment and overpayment of prescription claims for Health Insurance
- the use of advertising not approved by the Department
- failure to pay policyholder's benefits on terminated policies

In the case of one company, the market conduct examination disclosed indications of insolvency that prompted a Department financial examination and ultimately led to the company being placed in receivership. In other instances the market conduct examination and subsequent Department follow-up led to correction of the problems.

However, market conduct examinations need to be used in conjunction with complaint data already in the Department's files. (page 36) Further, the Department does not engage in some public interest activities that are provided by other state insurance departments. (page 40)

SUNSET FACTOR: THE EXTENT TO WHICH RULES  
AND REGULATIONS PROMULGATED BY THE DEPARTMENT  
ARE CONSISTENT WITH THE LEGISLATIVE MANDATE

The Arizona Attorney General reviews all rules and regulations proposed by the Department of Insurance to ensure that 1) the rules and regulations are within the authority of the Department and 2) the goals and objectives of the rules are consistent with the Department's statutory authority.

SUNSET FACTOR: THE EXTENT TO WHICH THE  
AGENCY HAS ENCOURAGED INPUT FROM THE  
PUBLIC BEFORE PROMULGATING ITS RULES AND  
REGULATIONS AND THE EXTENT TO WHICH IT  
HAS INFORMED THE PUBLIC AS TO ITS  
ACTIONS AND THEIR EXPECTED IMPACT  
ON THE PUBLIC

The Department's efforts in publicizing proposed rules and public hearings are comparable to the other Arizona State agencies. A survey of State agencies by the Office of the Auditor General revealed that most agencies file proposed rules with the Secretary of State and post notices of public hearings in its building. These are the same actions taken by the Department of Insurance. In addition, the Department does send copies of the notices of hearings to the Capitol press room and industry groups.

SUNSET FACTOR: THE EXTENT TO WHICH  
THE DEPARTMENT HAS BEEN ABLE TO  
INVESTIGATE AND RESOLVE COMPLAINTS  
THAT ARE WITHIN ITS JURISDICTION

The Department has established a consumer complaint section which appears to be effective in investigating and resolving most complaints. In 1978 the Department handled more than 5,000 complaints and assisted consumers in obtaining 1.5 million dollars in payments from insurance companies and agents. Moreover, in 1978 the Department experimented with a program of having investigators visit the county seats of outlying counties to receive consumer complaints from rural residents. This program was known as the AIDS program, an acronym for Arizona Insurance Department Services. However, the public is still generally unaware of the consumer complaint section (page 36) and complaint data is not used to monitor the activities of insurance companies and agents. (page 36)

SUNSET FACTOR: THE EXTENT TO WHICH  
THE ATTORNEY GENERAL OR ANY OTHER  
APPLICABLE AGENCY OF STATE GOVERNMENT  
HAS THE AUTHORITY TO PROSECUTE ACTIONS  
UNDER ENABLING LEGISLATION

According to the Assistant Attorney General for the Department of Insurance the Attorney General has sufficient authority to prosecute actions under the enabling law. Further, the Department of Insurance is very cooperative in assisting the Attorney General in prosecuting cases. Such cases include instances involving joint investigations between the Department of Insurance, the Corporation Commission and the Banking Department.

SUNSET FACTOR: THE EXTENT TO WHICH  
THE DEPARTMENT HAS ADDRESSED DEFICIENCIES  
IN THE ENABLING STATUTES WHICH PREVENT  
IT FROM FULFILLING IT'S STATUTORY MANDATE

The Department has been active in addressing deficiencies in it's enabling statutes. In 1977, the Department submitted or actively supported ten bills which were passed by the Legislature. In 1978 the Department submitted or actively supported six bills which were passed by the Legislature. In the 1979 session the Department submitted or actively supported 11 bills of which eight were enacted into law.

As a result the Department has been partially responsible for statutory changes involving: the licensing and regulation of agents, the certification of insurers and the regulation of financial activities of insurers. Worthy of special note is the Department-supported 1977 legislation which increased capital and surplus requirements for insurers.

SUNSET FACTOR: THE EXTENT TO WHICH CHANGES  
ARE NECESSARY IN THE LAWS OF THE DEPARTMENT  
TO ADEQUATELY COMPLY WITH THE FACTORS LISTED  
IN THIS SUBSECTION

For a discussion of these issues see pages 13, 44 and 61.

FINDING I

QUARTERLY REMITTANCE OF INSURANCE PREMIUM TAXES TO THE STATE WOULD ENABLE THE STATE TREASURER TO INVEST THESE FUNDS SOONER AND EARN ADDITIONAL INTEREST INCOME. DURING 1979 THIS ADDITIONAL INCOME COULD HAVE BEEN AS MUCH AS \$1,660,000.

Arizona would have earned as much as \$1,660,000 in additional interest income if it required insurance companies to remit their insurance premium taxes as frequently as is required by some other states. This additional interest income could be earned without causing a significant increase in Insurance Department workload or staffing.

Insurance companies operating in Arizona are subject to a tax on gross insurance premiums collected\* and are exempt, except as to unrelated business income, from Arizona income tax. The volume of insurance sold in Arizona and the resultant insurance premium taxes have increased substantially in recent years as shown below.

Arizona Premium Tax Collections

<u>Year</u>	<u>Amount</u>
1960	\$ 3,275,189
1970	\$ 9,364,192
1975	\$21,841,928
1976	\$25,715,518
1977	\$29,606,406
1978	\$33,592,923
1979 (est.)	\$39,154,000

Arizona law (ARS 20-224) currently requires insurance companies to pay premium taxes once a year on March 31st for domestic corporations and March 1st for foreign corporations. However, 21 other states require insurance companies to remit insurance premium taxes more frequently than once a year. Table 2 summarizes the frequency of insurance premium tax collections by state. The states are listed in order based upon the volume of 1975 insurance premiums.

\* Premium tax rates are two percent of the total Arizona direct premium income for foreign or alien companies and one percent for domestic companies.

TABLE 2

SUMMARY OF FREQUENCY OF  
STATE PREMIUM TAX COLLECTIONS

	<u>State</u>	<u>Annual Premium (1) Volume</u>	<u>Frequency of Collection</u>
1	New York	\$13,794,252,385	Quarterly
2	California	11,887,068,000	Quarterly
3	Illinois	6,863,789,200	Quarterly
4	Texas	6,612,938,873	Annually
5	Pennsylvania	6,038,302,000	Annually
6	Ohio	5,727,314,982	Semiannually (foreign)
7	Michigan	5,628,856,526	Semiannually
8	Florida	4,492,449,372	Annually
9	New Jersey	4,301,021,569	Annually
10	Massachusetts	3,100,000,000 (2)	Quarterly
11	Indiana	3,027,000,000	Quarterly (foreign)
12	Missouri	2,611,410,337	Annually
13	Georgia	2,599,224,929	Quarterly
14	Wisconsin	2,508,317,314	Quarterly (foreign)
15	North Carolina	2,294,495,496	Annually
16	Minnesota	2,221,978,891	Quarterly
17	Maryland	2,186,186,649	Semiannually
18	Tennessee	2,000,374,556	Semiannually
19	Virginia	1,970,990,841	Quarterly
20	Louisiana	1,950,934,821	Annually
21	Washington	1,808,551,312	Annually
22	Alabama	1,800,000,000 (2)	Annually
23	Oregon	1,711,147,450	Annually
24	Connecticut	1,631,511,132	Semiannually (foreign)
25	Iowa	1,359,788,382	Annually
26	Colorado	1,336,406,523	Quarterly
27	Oklahoma	1,279,326,466	Quarterly
28	Kansas	1,270,978,641	Annually
29	South Carolina	1,156,045,149	Annually
30	Kentucky	1,145,052,773	Triannually
31	ARIZONA	1,089,237,971	Annually
32	Arkansas	859,498,786	Annually
33	Nebraska	849,752,815	Annually
34	Mississippi	827,224,181	Annually
35	West Virginia	677,403,416	Annually
36	Utah	515,637,482	Annually
37	Rhode Island	490,265,447	Triannually
38	New Mexico	478,133,285	Annually
39	District of Columbia	475,000,000	Annually
40	Maine	425,969,091	Quarterly
41	New Hampshire	410,517,043	Semiannually
42	Idaho	396,374,122	Annually
43	Hawaii	377,320,730	Monthly or quarterly
44	South Dakota	359,221,176	Annually
45	North Dakota	319,984,589	Annually
46	Montana	308,000,000	Annually
47	Delaware	285,056,818	Annually
48	Nevada	278,714,500	Annually
49	Alaska	264,828,991	Annually
50	Vermont	167,357,778	Annually
51	Wyoming	91,536,205	Annually

- (1) Listed in order from the largest 1975 annual premium volume to the smallest  
(2) Estimated



If Arizona collected insurance premium taxes as frequently as some of the states shown in Table 2, the State could invest these funds earlier and earn additional interest income.\* Table 3 illustrates the additional income that would have accrued to the State of Arizona during 1979 if it collected insurance premium taxes as frequently as New York, California or Illinois. These three states were selected for comparative purposes because New York, California and Illinois are the three largest states in terms of annual insurance premiums.

As shown in Table 3, the State of Arizona could have earned from \$1,180,000 to \$1,660,000 in additional interest income if it collected insurance premium taxes as frequently as New York, California or Illinois. It should be noted that the amount of additional interest income resulting from more frequent collection of insurance premium taxes will increase as insurance premium taxes and/or as the annual rate of return on investment for the State of Arizona increases. If future premium tax collections meet or exceed current estimates almost \$1,900,000 in additional interest could be earned in 1980.

Although the State could have earned from \$1,180,000 to \$1,660,000 during 1979 by collecting insurance premium taxes more frequently, the costs to the Department to process these additional remittances would be relatively insignificant. Currently in Arizona there are 1,700 insurance companies subject to insurance premium taxes. However, of these 1,700 companies only 850 pay more than \$1,000 and 600 pay more than \$5,000, in annual insurance premium taxes. If only those companies with annual insurance premium taxes in excess of \$1,000 or \$5,000 were required to remit their taxes quarterly, Department of Insurance officials estimate it would require two additional employees at a cost of \$30,000 to process these additional remittances. This additional cost is less than two percent of the additional interest income that could have been earned in 1979 if insurance premium taxes had been collected more frequently.

\* Based upon an annual rate of return on investment of 9 percent. Currently the State of Arizona invests temporarily excess State funds to earn additional revenue. According to the State Treasurer the annual rate of return on investment for 1979 is projected to be 9 percent.

TABLE 3

ADDITIONAL INTEREST INCOME THAT  
WOULD HAVE ACCRUED TO THE STATE  
OF ARIZONA DURING 1979 IF IT  
COLLECTED INSURANCE PREMIUM TAXES  
AS FREQUENTLY AS NEW YORK,  
CALIFORNIA OR ILLINOIS

	<u>Illinois</u>	<u>New York</u>	<u>California</u>	<u>Arizona</u>
Arizona Premium Taxes for 1979 (est.)	\$39,154,000	\$39,154,000	\$39,154,000	\$39,154,000
Actual Taxes for Prior Year (1978)	\$33,592,923	\$33,592,923	\$33,592,923	\$33,592,923
Minimum Tax Subject to Quarterly Collections	\$ 5,000	\$ 1,000	\$ 5,000	-
Amount of 1979 Taxes Subject to Quarterly Collections (based on prior years actual tax and minimum tax provisions)	\$32,793,412	\$33,471,989	\$32,793,412	-
Amount of Quarterly Payments	25% of prior years actual tax	25% of prior years actual tax	1st 3 payments 26 1/2% of prior years actual tax	-
Quarterly Collection Dates	April 1979 June 1979 Sept. 1979 Dec. 1979	March 1979 July 1979 Oct. 1979 Jan. 1980	May 1979 Aug. 1979 Nov. 1979	- - - -
Final Collection Date	March 1980	March 1980	April 1980	March 1980
Additional Interest Earned @ 9% interest by Collecting and Investing Taxes Quarterly	<u>\$ 1,660,000</u>	<u>\$ 1,550,000</u>	<u>\$ 1,180,000</u>	<u>\$ -0-</u>

CONCLUSION

Arizona does not collect insurance premium taxes as frequently as 21 other states. Had Arizona required insurance companies to remit their insurance premium taxes as frequently as is required by some other states an additional \$1,660,000 in interest income could have been earned during 1979.

RECOMMENDATION

We recommend ARS 20-224 be revised to provide for quarterly collection of all premium taxes in excess of \$1,000.

## FINDING II

### IMPROVEMENTS NEEDED IN THE LICENSING PROCEDURES OF THE DEPARTMENT OF INSURANCE

The Licensing Section of the Department of Insurance annually licenses more than 17,000 insurance agents, brokers, adjustors and solicitors. Our review of the Licensing Section revealed that current licensing procedures and policies cause unnecessary delays in issuing licenses and that the Section's staffing level is excessive.

The time required for the Licensing Section to issue a license can be reduced by as much as 3½ weeks, Section staffing reduced by as much as five full-time positions and Department expenditures reduced by as much as \$51,800 per year if the Department:

- 1) amends its policy regarding fingerprint checks and
- 2) eliminates current inefficiencies in the licensing process.

Table 4 summarizes the areas of potential improvement in the licensing procedures of the Department of Insurance, and the benefits these improvements would generate in terms of reduced license processing time, staff requirements, and Department expenditures.

TABLE 4

SUMMARY OF AREAS OF POTENTIAL IMPROVEMENTS  
IN THE LICENSING PROCEDURES OF THE DEPARTMENT  
OF INSURANCE AND THE BENEFITS THESE IMPROVE-  
MENTS WOULD GENERATE IN TERMS OF REDUCED  
LICENSE PROCESSING TIME, STAFF REQUIREMENTS  
AND DEPARTMENT EXPENDITURES

<u>Areas of Potential Improvements in the Licensing Procedures of the Department of Insurance</u>	<u>Reduced License Processing Time (Days)</u>	<u>Reduced Staff Requirements (F.T.E.)</u>	<u>Reduced Department Expenditures (Annual)</u>
1. Issue licenses before the results of F.B.I. fingerprint checks are received (page 19)	23		
2. Improve telephone procedures (page 24)		2.00	\$16,000
3. Use computer to type and mail license (page 25)	3	.34	\$ 2,700
4. Use video-terminals to input licensing data (page 26)		.16	\$ 5,100*
5. Use private firms to perform testing and fingerprinting functions (page 26)	<u>7</u>	<u>2.50</u>	<u>\$20,000</u>
Cumulative Benefits	<u>23**</u>	<u>5.00</u>	<u>\$43,800</u>

\* Includes savings in processing costs as well as staffing.

\*\* Because some events in the licensing process occur concurrently, these reduced processing times are not cumulative.

Issue Licenses Before the Results of  
FBI Fingerprint Checks are Received

The primary cause of delays in the issuance of licenses by the Licensing Section of the Department of Insurance is the fingerprinting of applicants. It is the policy of the Department to not issue a license to an applicant until the Department receives the results of a Federal Bureau of Investigation (FBI) fingerprint check on the applicant. This policy delays the issuance of licenses to applicants approximately three weeks and imposes an unnecessary financial hardship on applicants.

The Department fingerprints all license applicants at the time of application. The Department sends the applicant's fingerprints to the FBI to verify the applicant's responses on its license application regarding any criminal record. This process takes approximately six weeks and delays the overall licensing process approximately three weeks. Table 5 summarizes the average elapsed time in days for the steps in the Department of Insurance licensing process.

TABLE 5

SUMMARY OF THE AVERAGE ELAPSED  
TIME IN DAYS FOR THE STEPS IN  
THE DEPARTMENT OF INSURANCE  
LICENSING PROCESS

<u>Steps in the Licensing Process</u>	<u>Elapsed Time in Days From the Preceding Step</u>	<u>Cumulative Elapsed Time in Days</u>
1. Applicant submits application and fingerprints	-	-
2. Applicant takes examination	18	18
3. Examination scores mailed to applicants	7	25
4. Fingerprint check received from the FBI and license mailed to successful applicants	23	48

A survey conducted by the office of the Auditor General revealed that the 23-day waiting period between steps 3 and 4 above is viewed by applicants, insurance agent associations and insurance companies as imposing an unnecessary financial hardship on applicants in that applicants cannot begin employment as insurance agents until they receive their licenses from the Department. These groups also maintain that the vast majority of applicants do not have criminal records and that these applicants are unfairly penalized because of the few applicants that do have records. These groups further noted that the Department can at any time revoke the license of any person who lied on their application regarding any criminal record. Therefore, the risks associated with issuing licenses before the Department receives the results of the FBI fingerprint checks do not justify the additional license processing time.

A review of the insurance applicant fingerprint checks made by the FBI during 1978 supports the contention there would be little risk in issuing licenses before fingerprint results are received. For example, of the applicants fingerprinted during 1978:

- Only 6% had criminal records. Of 4,212 applicants, only 252 had criminal records. Many of the records were for driving while under the influence of alcohol.
- Only 0.5% were denied licenses because of criminal records. Of 4,212 applicants, only 20 were denied licenses because of criminal records.
- Many of the applicants that were denied licenses because of a criminal record had correctly reported their record on their application. In a test sample of 51 applicants, only three were denied licenses because of criminal records. However, all three applicants correctly reported their record on their application.

Based upon the above review it appears there is little risk in licensing applicants before fingerprint results are received. However, the policy of fingerprinting applicants appears to be a sound one in that 1) fingerprinting offers a control over the truthfulness of applicant responses on applications and 2) the service is performed by the FBI without charge to the Department. Further, it appears that the practice of fingerprinting may deter persons with criminal records from applying for licensure. For example, prior to 1976-77 the Department fingerprinted applicants but did not compare the results of the fingerprint check against the applicant's responses on the license application. A review of the Department's records revealed that eleven percent of the applicants prior to fiscal year 1976-77 had criminal records. However, since the Department has begun to follow up on fingerprint results the number of applicants with criminal records has dropped to six percent.

## Screen Applications and Schedule

### Tests "Over the Counter"

An indeterminable but potentially substantial amount of time in the licensing process of the Department could be eliminated if license applications were screened and tests scheduled "Over the Counter" when applicants personally bring their applications to the Department.

Currently, two-thirds of the applicants for new licenses bring their applications to the Department. Instead of a Licensing Section employee reviewing the application for correctness and scheduling the examination while the applicant is there, the application is placed in a basket and reviewed later. This procedure is inefficient and potentially wasteful of time in that;

- Some applications are not reviewed by the Department until ten days after they are received.
- If a problem is detected on the application, the Department must write the applicant who then must provide the needed information.
- Even if no problem is detected on the application the Department must write the applicant to schedule the examination.
- Department personnel spend as much as eight hours per week typing letters to applicants regarding problems with applications and scheduling examination dates.

"Over the Counter" screening of applications brought to the Department, and scheduling of tests would eliminate 1) the time delays identified above, and 2) the eight hours of staff time spent on typing.



### Realign Key Employee Functions

Three employees in the Licensing Section are primarily responsible for processing all new licenses. Realignment of license processing responsibilities among these employees would help prevent delays in issuing licenses.

Currently, each of the three Licensing Section employees is responsible for performing the following tasks for an assigned group of new license applications.

- reviewing applications
- monitoring license examinations
- grading license examinations
- notifying applicants of license examination results
- typing the licenses
- typing congratulatory letters to the applicants
- preparing computer input documents
- preparing agent folders
- answering telephone inquiries

A problem is created when the employee is interrupted while performing a task. For example, if an employee is grading an examination and is interrupted to prepare computer input documents or some other duty, the examination will be put aside and left until the employee can find time to grade it. This present system may prevent an applicant from receiving his or her license in the minimal amount of time.

Realignment of new license processing responsibilities, so that specific employees were responsible for specific licensing tasks would help to prevent 1) new license applications from being delayed at various processing steps, and 2) the resultant overall delays in issuing licenses that invariably follow such detainments.

### Improve Telephone Procedures

The amount of time spent by Licensing Section employees on the telephone answering inquiries can be reduced by approximately 15 hours per day if specific employees were trained to answer the most frequently asked questions.

Licensing Section employees currently spend an average of 30 hours each day, or the equivalent of four full-time positions, on the telephone answering inquiries. There are eight employees in the Licensing Section whose responsibility it is to initially answer the telephones and provide information if they are qualified to do so. However, our study revealed that:

- More than 50 percent of the telephone calls to the Licensing Section involve questions of a general nature such as agent qualifications.
- The employees initially answering the telephones in the Licensing Section are not qualified to answer such questions and must transfer the call to another Section employee.
- The other Section employee to whom the call is transferred is usually one of the Section's key employees (page 23) who must stop processing license applications to answer the caller's question.

Therefore, more than half the time the current Licensing Section telephone procedures result in two employees responding to one telephone call and frequent interruptions and resultant delays in the processing of license applications. If specific Licensing Section employees were trained to answer telephones and respond to questions of a general nature 1) total staff hours spent on the telephone could be reduced by approximately one half, or 15 hours per day, and 2) the equivalent of two full-time positions could be reassigned to other duties.

Use Computer to Type  
and Mail Licenses

The use of available computer capacity by the Licensing Section to print licenses, and type and address congratulatory letters would reduce staff workload.

The Department currently uses the equivalent of a 1/3 full-time position to hand type all new licenses, renewal licenses needing correction, and congratulatory letters from the Director to successful applicants. This manual process is time consuming and unnecessary in that the Department's computer is already programmed to type licenses and can be easily programmed to correct renewal licenses and type and address congratulatory letters.

The Arizona Real Estate Department, which issues approximately twice as many licenses as the Department of Insurance, currently uses its computer to print licenses. The Real Estate Department computer produces a three-part form which includes a printed license, an addressed envelope and a duplicate license for the Department's files.

By expanding the use of its computer to type licenses, congratulatory letters and envelopes the Department would reduce the workload in the Licensing Section approximately 1/3 of a full-time equivalent position.

#### Use Video-Terminals to

##### Input Licensing Data

The use of video-terminals to input licensing data into the computer would reduce staff workload and costs.

Licensing Section employees currently hand post licensing information onto computer coding forms. These forms are sent to the Department of Administration where the information is keypunched and entered into the computer. A study by the Department of Administration's Data Center revealed that 1) it would be more efficient for the Insurance Department to use video-terminals to input licensing information into the computer and 2) the use of video-terminals would generate a net annual savings to the Department of approximately \$4,000 in that Department of Administration keypunching charges (\$8,500 during fiscal year 1977-78) would be eliminated. In addition, it appears that the use of video-terminals would reduce the Licensing Section workload approximately 1/6 of an equivalent full-time position.

#### Use Private Firms To Perform

##### Testing and Fingerprinting Functions

The Department currently tests and fingerprints license applicants. These functions can be performed more efficiently by private companies with resultant reductions in Licensing Section staff requirements.

##### Testing

Department personnel currently perform all of the functions associated with testing license applicants. Department personnel develop, monitor and grade examinations and notify applicants of their scores.

In order to evaluate the testing of applicants the Office of the Auditor General reviewed Department testing practices and policies and observed two actual examination sessions. This review revealed that:

- The Department uses the equivalent of two full-time positions to perform the functions associated with testing license applicants.
- The Department uses only one version of each test and some test contents have not been changed for four years. This allows test contents to be communicated by word of mouth, thereby compromising the test. It also allows applicants who retake the test to "learn the test" rather than the subject matter.
- The Department does not have adequate testing space. As a result, applicants sometimes sit shoulder to shoulder during testing sessions with answer sheets only six inches apart, thereby jeopardizing the integrity of the testing process.
- Department personnel do not maintain adequate security during testing sessions. It was observed that identification is not always checked when applicants report to examining areas. It was also observed that monitors left the applicants unattended twice during one examination session for periods of five to ten minutes.

Educational Testing Service (ETS) is a nationwide, professional testing service. Currently, there are seven state Insurance Departments (Colorado, Delaware, Illinois, Indiana, Massachusetts, Pennsylvania and Wisconsin) that use ETS to perform all of the testing functions currently being performed by Department personnel. The Insurance Departments using ETS reported to the Office of the Auditor General that they previously performed all of the testing functions themselves but encountered many of the same problems the Arizona Department is presently experiencing. These Insurance Departments stated that by using ETS:

- The Department workload was reduced
- The content quality of the examinations improved
- The examinations were revised by ETS at least once a year
- Testing facilities were improved as ETS provides its own testing facilities
- Examination monitoring and security improved

Based upon our review of the testing practices and policies of the Department and the experience of the seven state Insurance Departments that use ETS, it appears that overall insurance licensing test quality would improve and Department workload would decrease if the Department used ETS to perform its testing functions. While there would be no additional cost to the State, it should be noted that the use of ETS would necessitate an increase in the examination fee charged license applicants. However, even an increased insurance examination fee would be lower than that charged for most occupational examinations in Arizona as shown in Table 6.

TABLE 6

A COMPARISON OF EXAMINATION FEES  
FOR PROFESSIONAL LICENSES IN ARIZONA

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<u>License</u>	<u>Fee</u>
Medical Doctor	\$200
Veterinarian	\$150
Contractor	\$135*
Psychologist	\$130
Dentist	\$125
Chiropractor	\$100
Certified Public Accountant	\$100
Pharmacist	\$100
Osteopath	\$ 75
Barber	\$ 50
Nurse	\$ 50
Optometrist	\$ 25
Naturopath	\$ 25
Real Estate Agent	\$ 25
INSURANCE Agent - Present	\$ 5-\$10**
INSURANCE Agent - Using ETS	\$ 17-\$34**

\* \$135 is the lowest examination fee charged for a contractor's license.

\*\* Fees vary depending upon the number of insurance lines for which the applicant wishes to be tested.

Fingerprinting

The Department currently uses the equivalent of a 1/2 full-time position to fingerprint license applicants. This function can be performed more efficiently by private companies.

Department of Insurance personnel fingerprint all insurance license applicants and forward the fingerprints to the Federal Bureau of Investigation (FBI) for review. (page 19) The Arizona Real Estate Department, however, uses private companies to fingerprint license applicants. The following comparison between the fingerprinting processes at the Department of Insurance and the Real Estate Department demonstrates the benefits of using private companies to fingerprint applicants.

TABLE 7

A COMPARISON OF THE FINGERPRINTING  
PROCESSES AT THE REAL ESTATE DEPART-  
MENT AND THE DEPARTMENT OF INSURANCE

<u>Measurable Attributes</u>	<u>Department of Insurance</u>	<u>Real Estate Department</u>
Staff time devoted to finger- printing applicants	1/2 full-time position	None
Cost to applicants	No charge	\$2 if taken at the Department. No charge if taken at law enforcement agency
Average number of applicants initially fingerprinted each month	420	2,100
Percent of initial fingerprints returned by the FBI as being unreadable	20%	4%

The percentage of fingerprints returned by the FBI as being unreadable is important because in the event the fingerprints are unreadable, the applicants must be fingerprinted again. Refingerprinting is inconvenient for applicants and adds time to the entire licensing process. It is noteworthy that the percentage of returned initial fingerprints is five times higher for the Department of Insurance and yet the Real Estate Department fingerprints five times as many applicants.

Replace Pool Employees

With Permanent Employees

Currently, four Department of Insurance pool employees are used exclusively in the Licensing Section. This practice is inefficient and an apparent circumvention of legislative intent.



The Licensing Section is authorized 12 full-time equivalents (FTE's). In actuality, however, the Licensing Section staffing level is 16 FTE in that four Department pool employees are used exclusively and on a full-time basis by the Licensing Section. These four pool employees, at a salary cost of \$33,500 per year, are not shown against the Licensing Section authorized staffing level. As such, the use of these four employees as de facto Licensing Section employees has never received official legislative sanction. Therefore, it appears that a Licensing Section staffing level of 16 FTE constitutes a circumvention of legislative intent. However, implementing the efficiencies discussed in the previous pages would reduce staffing by six FTS's thereby eliminating the need for these four pool employees.

#### CONCLUSION

Licensing Section procedures and policies cause unnecessary delays issuing licenses and create a need for excessive staffing. The time required to issue a license can be reduced by as much as 3 1/2 weeks, Section staffing by as much as five full-time positions and Department expenditures reduced by as much as \$43,800 per year if 1) the Department amends its fingerprinting policy and 2) current licensing inefficiencies are eliminated.

#### RECOMMENDATION

1. We recommend that the Department of Insurance issue licenses before the results of FBI fingerprint checks are received. We also recommend the Department continue to investigate and take appropriate action when FBI fingerprint checks disclose criminal records not previously stated on license applications.
2. We recommend that the following changes be made in work procedures:
  - a) screen applications and schedule examinations "over the counter" rather than by mail.
  - b) realign tasks assigned to key employees.
  - c) train specific employees to answer all general telephone inquiries.
  - d) use the computer to type licenses and envelopes.
  - e) use video-terminals to input data to the computer.

3. We recommend that the Department of Insurance use private companies to conduct testing and fingerprinting of applicants.
4. We recommend that the Department of Insurance discontinue the practice of using pool employees as de facto Licensing Section employees.

### FINDING III

THE PUBLIC IS UNAWARE THAT CONSUMER COMPLAINT SERVICES ARE AVAILABLE TO ASSIST THEM. ALSO, THE DEPARTMENT IS FAILING TO USE THE COMPLAINT DATA IT HAS TO REGULATE COMPANIES AND AGENTS.

The Consumer Complaint Section of the Department of Insurance annually receives and processes more than 5,000 written complaints against insurance companies and agents. The Department is generally effective in its actions with these complaints. However, the public is generally unaware the Department offers such services, and little is done by the Department to use complaint data in the regulation of companies and agents.

#### The Public Is Unaware of Consumer Complaint Services

Despite the fact that consumer complaint investigations are both effective and free of charge, Arizona consumers appear to be largely unaware that the Department offers these services. Overall complaint ratios are significantly lower than those of several other states and many of the complaints that are filed are initially directed to other entities because of the lack of public awareness of the Department's consumer services. Further, most complainants learn of these services by "word of mouth." Several other state insurance departments have developed programs to increase public awareness of consumer complaint services.

#### Complaint Ratios Are Low

The Arizona Department of Insurance receives fewer complaints per 1,000 population than the average for 46 other states. Further, Arizona receives significantly fewer complaints per 1,000 population than the ten leading states. Table 8 compares Arizona's complaint ratio with those of the ten leading states and the average complaint ratio for all states.

TABLE 8

A COMPARISON OF ARIZONA'S NUMBER OF COMPLAINTS  
PER 1,000 POPULATION WITH THOSE OF THE TEN LEADING  
STATES AND THE AVERAGE FOR 46 STATES

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<u>State</u>	<u>Complaints/1,000</u>
Delaware	25.05
Georgia	21.44
Kansas	5.58
North Carolina	5.21
Florida	4.66
Nevada	4.04
Colorado	3.53
Maryland	3.47
Pennsylvania	3.39
New York	3.30
Average for 46 States*	3.14
ARIZONA	2.22

\* Complaint data was not available from three  
states: Alabama, Missouri and Rhode Island.

As shown in Table 8, the ten leading states have complaint ratios from 1 1/2 to 11 times greater than Arizona's. Arizona's relatively low complaint ratio may manifest a general public unawareness of the Department's complaint services.

#### People Don't Know Where to Complain

As much as 20% of the people who do file complaints with the Department initially contact other entities because they do not know the Department's services exist.

The Office of the Auditor General contacted seven entities consumers might call to resolve an insurance complaint. These entities were: The Better Business Bureau, the Governor's Office, the Office of the Attorney General, The Corporation Commission, the Department of Economic Security, the Department of Public Safety and the Capital Switchboard. These entities receive and refer more than 100 calls per week regarding insurance complaints. It should be noted that in most cases, these callers were not initially aware that the Department of Insurance existed.

The 100 calls per week referred by the above seven entities is significant in that 1) many formal written complaints first begin as telephone inquiries and 2) these 100 calls per week represent 15% to 20% of the volume of telephone inquiries received by the Department of Insurance each week.

Most People Learn About the  
Services by "Word of Mouth"

An additional indication of the lack of public awareness of the Department's consumer complaint services is that most people learn of these services by "word mouth." An Auditor General survey of persons who filed complaints with the Department of Insurance during 1978 revealed that 55% of these complainants learned of the Department's services from friends, relatives or insurance agents. This fact coupled with the high volume of consumer complaints that are initially filed with entities other than the Department of Insurance indicates the need for a more vigorous program to increase public awareness of the Department's consumer complaint services.

Methods Used by Other States to  
Increase Public Awareness of Services

According to Department of Insurance officials, the Department has not extensively publicized its consumer complaint services because of time constraints. An occasional news release or public speech constitutes the extent of the Department's publicity efforts in 1978. Those news releases that were issued in 1978 were confined to small, rural newspapers to increase rural awareness. The limited public speeches that were made in 1978 were for the most part presented at insurance industry meetings, not to the general public.

During one survey of other state insurance departments, we identified several methods that are being used to increase public awareness of consumer services that could also be used by the Arizona Department of Insurance. For example, eight states reported extensive use of public speaking engagements to community groups (such as schools, senior citizen associations, and civic groups) to publicize services. Seven states heavily use the news media. One state reported its insurance commissioner and staff appear on television and radio programs to explain public services. Another state issues "consumer alerts" to the news media. Finally, three states have the media publicize toll-free numbers persons can call if they need consumer services.

Greater Use Needs to Be  
Made Of Complaint Data

The compilation and analysis of consumer complaint data is a potentially effective means of monitoring and investigating the conduct of insurance agents, agencies and companies. For example:

The investigation of a single complaint may disclose an act or practice that is serious enough by itself to warrant further action.

Analysis of total complaint data may disclose patterns of behavior which require further investigation. In these instances an individual complaint may not require action but a number of such complaints may be indicative of a problem.

Our audit revealed that the Department generally takes appropriate action when it appears that an individual complaint warrants further investigation. The Department does not, however, accumulate or analyze data on total consumer complaints as a means to identify patterns of inappropriate behavior by insurance companies or agents.

Total Complaints Against Companies

Insurance departments in at least four other states (Wisconsin, Illinois, Pennsylvania and Massachusetts) analyze total complaints against companies to look for "problem" companies. These departments analyze the numbers of complaints in relation to the companies' volume of business (complaints/million dollars of premium volumes). For example, the Wisconsin Insurance Department selects all Accident, Health and Auto insurance companies with ten or more complaints and calculates the ratio of complaints to million dollars of premium volume. An average ratio for those insurance companies is developed and all companies with higher than average complaint ratios are identified.

By identifying companies with higher than average complaint ratios the Wisconsin Insurance Department 1) can better select companies requiring further investigation and/or market conduct examinations, and 2) can bring public pressure on companies to reduce complaints in that the calculated complaint ratios are published in newspapers.

#### Investigations and Market Conduct Examinations

The market conduct examinations that are performed by the Arizona Department of Insurance are designed to review treatment of policyholders by insurance companies. However, the department does not formally use consumer complaint data to determine companies that should be considered for such examinations. Other states, such as Wisconsin and California, review the differences in complaint ratios in determining which companies receive investigations and market conduct examinations. Analysis of Arizona's complaints against companies revealed wide differences in complaint ratios. For example, the company with the highest complaint ratio had 1,100 times the ratio of the company with the lowest ratio. (577 complaints per \$100,000 of business compared to .49 complaints per \$100,000 of business.)

The Department does not currently develop complaint ratios and therefore, cannot use consumer complaint data to identify potential problem companies. Instead, the Department subjectively reviews the number and types of complaints received against companies and "call in" companies for informal hearings when they believe the number of complaints is inordinately high. The Department does not maintain records of companies "called in," but department officials identified six companies that were "called in" during 1978. A review of complaint ratios for 1978 showed that only one of the six companies "called in" had an above average complaint ratio while fifteen companies with higher complaint ratios were not "called in." Further, the fifteen companies that were not "called in" had complaint ratios that were from 6 (for life-disability companies) to 78 times (for property-casualty companies) higher than the complaint ratios of the companies that were "called in." It should be noted that none of these fifteen companies received a market conduct examination during 1978. A comparison of the complaint ratios of the six companies "called in" and the fifteen companies not "called in" is shown in Table 9.

TABLE 9

A COMPARISON OF COMPLAINTS/\$100,000 OF  
BUSINESS FOR COMPANIES "CALLED IN" AND NOT  
"CALLED IN" BY THE DEPARTMENT OF INSURANCE

<u>Companies "Called In"</u>	<u>Companies Not "Called In"</u>	
91.16	576.95	31.82
5.84	453.72	29.41
5.82	80.59	29.23
3.60	67.41	29.15
2.85	58.41	28.88
1.90	57.82	26.38
	54.05	25.14
	45.72	

Public Pressure

Developing data on complaint ratios also provides a potentially powerful tool for using public pressure to regulate companies. In Wisconsin, Illinois and Massachusetts such complaint ratio data is either published by the departments or made available to the press. This public disclosure of complaint data provides an added incentive to reduce and resolve complaints.

Total Complaints Against Agents

At least two other states (Wisconsin and Kentucky) also monitor data on total complaints against agents. In both states agents are investigated when (a) a serious complaint is received and/or (b) two complaints are received against an agent.

Arizona does not formally monitor complaints against agents; however, the complaints section supervisor has advised us that three complaints against an agent might warrant an investigation. During our review, we identified fourteen agents that received three or more complaints in 1978. However, only two of the fourteen agents were brought before formal departmental hearings.\* It should be noted that in these cases it was the seriousness of the complaints rather than the number of complaints that led to the investigation and hearing. Further, it appears that monitoring complaints could have prevented some harm to customers. For example, one of these agents had amassed seven complaints before being brought to hearing.

\* The Department revoked the licenses of both agents.



No formal action was taken by the Department against the other twelve agents with three or more complaints (one of which had seven complaints and two had six complaints). It should be noted that it is relatively rare for an insurance agent in Arizona to have one complaint filed against them. Of the insurance agents in Arizona, less than 4% had a complaint filed against them in 1978 and only .08% had three or more complaints filed against them.

#### CONCLUSIONS

It appears that the public is generally unaware of the Department of Insurance's consumer complaint services. Further, the Department is not compiling and analyzing consumer complaint data to identify potential problem insurance companies, agencies and agents. As a result, Arizona consumers may have complaints but be unaware of where to find help and the Department's ability to identify and regulate problem insurance companies, agencies and agents is diminished.

#### RECOMMENDATIONS

1. We recommend that the Department actively seek to publicize its complaint services.
2. We recommend that the Department develop and analyze data on complaints/\$100,000 dollars of premium volume. We recommend further that this data:
  - (a) be used to determine which companies receive further investigation and market conduct examinations
  - (b) be publicized either by release to the press or by publication in the Department's annual report
3. We recommend that the Department monitor total complaints received by each agent and conduct investigations of all agents receiving more than a specified number of complaints.

## FINDING IV

### GREATER DEPARTMENT ACTION IS NEEDED WITH REGARD TO THE PUBLIC INTEREST AS IT PERTAINS TO CONSUMER EDUCATION AND PUBLIC INVOLVEMENT.

The Arizona Department of Insurance is substandard with regard to the development of consumer brochures and the development of readability regulations when compared to other state insurance departments. In addition, the Department has been generally unsuccessful in involving the public in the making of rules and regulations.

#### Consumer Brochures

Most other state insurance departments have found it to be in the public interest to encourage and facilitate consumer education. At least thirty-three other states now prepare and distribute consumer brochures covering a variety of topics including guides on how to buy health, automobile, homeowners and life insurance. Other brochures are designed to inform consumers of their rights and/or tell them how to resolve complaints. Several states also publish insurance price comparisons to show consumers the savings available by shopping for insurance.

The Arizona Department of Insurance has not developed any consumer brochures. According to Department officials, the Department does not have the necessary staff or resources to develop consumer brochures. However, effective January 1, 1979, the Department did begin to require life insurance companies to furnish a buyer's guide\* with each policy sold. While this is noteworthy, a number of other states do more. For example, Pennsylvania has published more than 40 consumer brochures since 1971. (Appendix A) Kansas and Washington have published six and eight consumer brochures, respectively.

\* This guide was developed by the National Association of Insurance Commissioners and is included on Appendix B.

## READABILITY REGULATIONS

Although insurance policies are reviewed by the Department to eliminate ambiguous or misleading clauses, many consumers may still not understand their policies.\* This is due to the fact that the policies are still complicated documents containing many technical and legal terms unfamiliar to the consumer. Further, the language used to draft policies often does not facilitate reading. Some states, such as California and Wisconsin, have developed readability regulations to help consumers in understanding life and disability policies.

Readability regulations generally specify that policies must pass readability tests. They regulate the size of print that may be used and the arrangement of the policy. Policies developed for readability also often include examples to help the reader although this is not required. An actual example of a clause from a standard policy and an example of a clause from a readable policy are shown below.

### (Standard Policy)

RECURRENT DISABILITIES. Successive periods of total disability which occur while this policy is in force, and which result from the same or related causes will be considered as one continuous period of total disability if monthly income or a portion thereof was payable for the earlier of the two periods except that if the Insured has between such periods engaged in the Insured's regular occupation and performed all the important duties thereof on a full-time basis for at least six consecutive months, the latter period will be considered as a new and independent period of total disability and the benefits of this policy will be payable accordingly.

### (Readable Policy)

RECURRENT DISABILITIES. A period of disability due to the same or related cause as that of an earlier period of disability may be considered to be a continuation of the earlier period. This depends on how much time has passed from the end of earlier period to the date the current disability began. If less than six months have passed, we will consider it to be a continuation of the earlier period. If six months or more have passed, we will consider it to be a new period of disability.

Example: You were disabled for 14 months because of a severe knee injury. Four months after you recover, your knee fails and you are disabled. We consider this to be a continuation of the earlier period of disability.

\* A survey of persons filing complaints with the Department of Insurance revealed that many complaints originated because policyholders did not understand the provisions of their policies--particularly health insurance policies.

Comparing the two policies the reader finds the first provision is one sentence. The readable policy provision is stated in four sentences. Also, simpler words are used and an example is given in the readable policy.

ARS 20-1110.01 provides for the Department to adopt rules and regulations governing the form and readability of insurance policies. The Department has developed such regulations for Property-Casualty policies but not Life and Disability policies. The Department had initially delayed work with readability in Life and Disability policies until the National Association of Insurance Commissioners (NAIC) developed a model law on the subject. In July 1978 the NAIC did develop the Life and Health Insurance Policy Language Simplification Model Act.

#### Public Involvement

The Department has also done less than some other states to encourage public involvement in the regulatory process, in determining public need, and in obtaining public comment on rules and regulations. For example, at least seven other states have established consumer advisory committees or citizen's task forces to provide public input to the directors on insurance needs. In addition, nine states conduct "informational" public hearings in different geographic regions to gain public input on insurance needs.

#### CONCLUSION

The Arizona Department of Insurance is substandard with regard to the development of consumer brochures and the development of readability regulations when compared to other state insurance departments. Additional Departmental effort is needed to encourage and facilitate consumer education and public input.

RECOMMENDATIONS

1. We recommend that the Department of Insurance increase its efforts to develop brochures to better educate the Arizona consumer.
2. We recommend that the Department of Insurance either adopt readability regulations for Life and Disability policies or seek to have the NAIC model law on readability in these areas enacted by the Arizona State Legislature.
3. We also recommend that the Department consider establishing a consumer advisory committee to provide input about public need.

## FINDING V

PRIOR APPROVAL OF MOST PROPERTY CASUALTY INSURANCE RATES IS NOT NEEDED. CHANGING TO OPEN-COMPETITION WOULD ELIMINATE CURRENT PROBLEMS EXPERIENCED IN REVIEWING RATES AND ALSO ELIMINATE THE NEED FOR ADDITIONAL STAFF.

The Property-Casualty Division regulates the rates charged for automobile, home owner, fire and other forms of property and casualty insurance. Under a "prior-approval" law property-casualty rates must be filed with the Division and approved before being put into use in Arizona. The Division reviews the filings to determine that the rates are not "...excessive, inadequate or unfairly discriminatory." It appears that prior approval of insurance rates in Arizona is not necessary and could be eliminated for all but a few lines of insurance if the state adopted a competitive or "open competition" rating law and that by so doing the approval of insurance rates could be accomplished more economically and efficiently.

In reviewing the Department of Insurance's rate regulation function we reviewed the two types of rating systems: prior approval and open competition. Both systems are designed to achieve the same goals and appear to be equally effective. However, because open competition eliminates the approval of most rates it offers potential benefits to Arizona over the present prior approval system.

### Two Types of Rate Regulation

As noted above, the two types of rate regulation systems are prior approval and open competition. Prior approval requires companies to file their proposed rates with the Department of Insurance for approval before use. Rates must not be excessive, inadequate or unfairly discriminatory. Generally, the Department's review must be made within a specified time period. If the rate is not specifically denied within that time period it is "deemed" to be approved. If, however, the department subsequently finds the rates do not comply with its requirements it may hold a hearing and withdraw approval of the "deemed" rates.

Under open competition insurance rates are subject to the same criteria as with prior approval in that rates cannot be excessive, inadequate or unfairly discriminatory. However, under open competition rates need not be submitted to the Department for approval.\* Instead, competition among insurance companies is relied upon to control rates. Rates are assumed not to be excessive as long as adequate competition exists. It should be noted, however, that under open competition a prior approval system can generally be reimposed if it is found that adequate competition does not exist. In addition, some open competition states require rates to be filed with the state insurance department for informational purposes.

Historically, the prior approval system has been the dominant form of rate regulation. However, seventeen states have now adopted some form of open competition law, with the majority adopting such laws within the last ten years. Further, one major state, Illinois, has no rate regulation law. Rate-making in Illinois is subject only to applicable anti-trust statutes. Table 10 lists the eighteen open-competition states and the years they adopted their open-competition laws.

\* Except for special lines of insurance such as workman's compensation.

TABLE 10

EIGHTEEN STATES WITH OPEN-COMPETITION  
RATING LAWS

---

<u>State</u>	<u>Year Open-Competition Was Adopted</u>
California	1947
Colorado	1972
Connecticut	1969
Florida	1967
Georgia	1967
Hawaii	1974
Idaho	1969
Illinois	1972*
Minnesota	1969
Missouri	1972
Montana	1969
Nevada	1972
New Mexico	1975
New York	1970
Oregon	1969
Utah	1973
Virginia	1974
Wisconsin	1969

\* In 1972 Illinois' previous rate regulation law expired. Since 1972 Illinois has not had a rate regulation law.



The open competition rate regulation system has been studied and endorsed by: a U. S. Senate sub-committee, the National Association of Insurance Commissioners, the U. S. Department of Justice Anti-Trust Division and the National Commission for the Review of Anti-Trust Laws and Procedures. In 1968 the National Association of Insurance Commissioners (NAIC) recommended that either; (a) insurance commissions be granted authority to suspend prior approval where competition exists or, (b) prior approval laws be repealed and replaced with open competition laws.

### Open-Competition is Equally Effective In Meeting

#### The Three Goals of Rate Regulation

State law specifies that rates shall not be "...excessive, inadequate or unfairly discriminatory." These criteria may be viewed, however, as being encompassed in three broader goals of rate regulation defined by the NAIC as being availability, price and solidity. Data available from studies by the NAIC, the U. S. Justice Department, the California Insurance Department, the New York Insurance Department and the Virginia Insurance Department all show that open competition is equally as effective as prior approval in meeting the goals of rate regulation.

#### Availability

Availability refers to a prospective buyer's ability to obtain insurance. Where mandatory insurance requirements exist (such as in automobile liability) it also refers to the buyer's ability to obtain that insurance at standard rather than nonstandard or assigned risk rates. Therefore, availability is often measured by the number of persons who carry no insurance and/or the number of persons who are insured under non-standard and assigned risk plans. Increases in the number of uninsured persons and/or persons in non-standard coverage are indicative of reduced availability; conversely decreases in these numbers indicate increased availability.

Studies of the differences in availability between open competition and prior approval systems have been conducted by the NAIC (1974), the New York Insurance Department (1977) and the Virginia Insurance Department (1978). These studies show there is generally<sup>1</sup> no direct relationship between availability and the type of rating law. There is however, a direct relationship between availability and insurance company loss ratios and profits. When loss ratios increase companies apply more restrictive underwriting practices, thereby reducing availability. Thus, insurance is at least as available under open competition.

### Price

Price refers to a purchaser's ability to obtain insurance at a reasonable price. In the context of rate regulation, price also refers to "reasonable" profits for companies and the absence of uncontrolled price-fixing. Therefore, reasonableness of rates, reasonableness of profits and the degree of price-fixing ability (market concentration) are used to evaluate effectiveness.

Reasonable Rates Reasonable rates are important indicators of the effectiveness of a rate regulation system because of the fears that rates will skyrocket in the absence of regulation. Results of the New York, Virginia and Department of Justice studies suggest rates are as reasonable under open competition as they are under prior approval. Points brought forth by these studies include:

- National economic trends (such as inflationary and litigation costs) influence rates more than the type of rate regulatory system (New York, Virginia)
- if anything, statewide average rates tend to drop under open competition because more companies file rates below those of statewide rating bureaus (New York, Virginia)

<sup>1</sup> New York and Virginia found open competition did increase availability in fire and property insurance (respectively) but did not affect automobile insurance.

- open competition provides companies "...greater incentive to improve efficiency and reduce expenses."<sup>2</sup> (New York)
- companies under open competition do reduce rates when experience warrants it (U. S. Department of Justice)

Reasonable Profits. The concept of reasonable profits is directly related to the concept of reasonable or "non-excessive" rates. The profitability of companies becomes an indicator of the effectiveness of regulation. Studies by the NAIC and the New York Insurance Department show open competition is as effective as prior approval in regulating profitability.

In the NAIC study, profitability by line of insurance for five open competition and five prior approval states was compared using two different measures. This comparison lead the NAIC staff to report that:

"Many have contended that open competition rating laws will lead to situations in which insurers will earn excess profits...On the basis of the evidence which we have collected and the evidence from these studies which we reviewed, there is no statistical difference in profitability between open rating and prior approval states."<sup>3</sup>  
(emphasis added)

The NAIC study was supported by the New York Insurance Department study which found that profitability was basically dependent on long-run trends in underwriting losses and not the type of rate regulatory system used.

<sup>2</sup> The Open Rating Law and Property-Liability Insurance, State of New York Insurance Department 1977 p VI.

<sup>3</sup> Monitoring Competition: A means of regulating the Property and Casualty Insurance Business, (National Association of Insurance Commissioners, 1974), Volume 1, p. 341. hereinafter referred to as NAIC report.

### Solidity

Company solidity, or solvency, was perhaps the first goal of rate regulation. Concern over company failures caused by rate wars in the 1800s and early 1900s led to statutory requirements that rates be "adequate." The adequacy requirements were designed to ensure that companies' rate structures produced enough funds to cover present and future claims. Available evidence shows, however, that:

- (a) rate regulation for rate adequacy has little, if any, effect in preventing insurance failures, and
- (b) there are no differences in solvency between open competition and prior approval states.

The role of rate adequacy in insurance failures was studied by the NAIC and the following conclusions were reached:

- (1) Insurance failures are not caused by inadequate rates. Companies can, and do, become insolvent even when charging the maximum allowable rates.
- (2) In order of importance, insolvencies are caused primarily by
  - (a) inadequate initial financing, (b) poor underwriting,
  - (c) excessive operating expenses, and (d) poor investments.<sup>4</sup>

Studies by the California and New York Insurance Departments support the NAIC data. California reviewed the six domestic company failures it had under open-competition in a 19 year period. Three of the six failures were caused by improper diversion of funds. The other three insolvencies all involved companies that were charging rates substantially higher than the average rates.

New York studied 30 companies found to be impaired or insolvent since 1970. It found the causes were attributable to inadequate initial financing, poor underwriting practices, incompetent management and outright malfeasance.

<sup>4</sup> Ibid p. 384

While concluding that the effectiveness of rate regulation in preventing insolvencies is "dubious" the NAIC report noted insurance departments do have many alternatives to control insolvencies including: capital and surplus requirements, reserve requirements, investment limitations and periodic examinations. Also, most policy holders are now protected against insolvencies by guaranty funds.

No matter to what extent rates may or may not affect solvency, data shows solvency is not affected by the type of rate regulation system used. In a test of company solvency between five open competition and five prior approval states the NAIC found "...no difference in the solvency ranking for prior approval and open competition states."<sup>5</sup>

#### Benefits of Open Competition

Open competition rate regulation would provide the following benefits over the present system of prior approval rate regulation:

- (a) It would remove the State from a role it is questionable the State can effectively fulfill: determining proper rates.
- (b) it would eliminate long delays and procedural problems in reviewing rates, and
- (c) it would provide cost-savings in staffing.

#### Effectively Determining Rates

It does not appear the Department can effectively determine "proper" insurance rates for two reasons. First, experts question whether "a proper rate" for a company can, in fact, be objectively determined. Second, the Department does not have the actuarial expertise needed to properly analyze rates. Finally, the Department may not have the authority to approve rates in the manner it does. A move to an open competition rate regulation system would eliminate these problems.

<sup>5</sup> Ibid p. 387

Lack of Objectivity. A proper rate for a company cannot be determined objectively. Experts and department officials both state that rate-making involves several subjective factors. These factors can lead to different conclusions by different persons as to what is a proper rate. A study by the NAIC staff concluded "Reasonable men may differ both as to the approach used and the results achieved in the rate-making process."<sup>6</sup> The NAIC staff also cite another study that concludes.

"...that insurance rate-making is not an inevitably accurate and scientific calculation: It requires personal interpretation and judgement at every step. Therefore, not only is a rate which is proper for one company not necessarily so for another, but what appears to be proper rate in the estimation of one person is not necessarily proper in the judgment of another. From this viewpoint, there is no basis for presuming that the judgment of the insurance commissioner... is superior to that of...a filer."<sup>7</sup>

The matter of subjective judgment entering into rate-making and rate-approval processes may be indicated by the fact that rates are sometimes denied until relatively small adjustments are made. For example, we observed three filings in which the rate revisions originally requested and the rate revisions finally approved varied by 0.3%, 0.4% and 0.8%.

Actuarial Expertise. The department does not possess the necessary actuarial expertise to properly analyze rates.

6 Ibid p. 70

7 Frederick Crane, Automobile Insurance Rate Regulation; The Public of Price Competition. Columbus, Ohio: Ohio State University, Bureau of Business Research, 1962.

Although insurance rate-making does involve several subjective judgments much of the process is dependent upon highly technical actuarial studies which are submitted with the rate requests to justify the requested rates. For the Department to effectively determine whether the rates are justified, the Department must review the actuarial support. However, the Department has no actuary and is forced to rely on the part-time services of a retired actuary. Although this actuary is of great assistance to the Department his services are part-time only and as a result a limited number of filings receive actuarial review. For example, Department officials estimate 50% of all filings do not require an actuarial review and are routinely reviewed and approved. However, of the remaining filings that do require an actuarial review only 2% receive actuarial review. Thus, 98% of the rate filings that may require some actuarial review do not receive it.

Authority. The Department's authority to carry out the rate review process as it presently operates may also be questionable. ARS 20-351 and ARS 20-357 require the Department to hold a hearing to disapprove filings. However, only one hearing was held in 1978. According to Department officials this occurred because 1) the Department often cannot present actuarial testimony, and 2) companies desire to avoid hearings for publicity reasons. In addition, rate filings that are not approved when first submitted to the Department received "preliminary disapproval." These rate filings do not receive Department approval until acceptable rates are agreed upon between the Department and the submitting company. It is unclear at what point, if any, these procedures place the department in the position of setting rates. What is clear, however, is that if the Department is rate setting, either directly or indirectly, it is exceeding it's authority.

A March 27, 1979 opinion from the Arizona Legislative Council acknowledged that communication between the Director of Insurance and the companies was permitted, and to some extent encouraged, by statute. However, the Arizona Legislative Council noted

"Arizona Revised Statutes sections 20-350, 20-351 and 20-358 provide for the disapproval of certain rate filings, but the sections do not authorize the director to fix rates if the director does not approve of the rates filed.

. . . . .

To the extent that 'negotiating' results in the director setting rates either directly or indirectly, 'negotiating' is not permitted." (emphasis added)\*

In addition, the Assistant Attorney General who represents the Department questions the Department "negotiating" rates. The Assistant Attorney General stated that informal negotiations between the Department and insurance companies produces an unhealthy atmosphere because the negotiations are conducted in private. He suggested that harder questions would be asked and broader issues addressed during the public hearings.

#### Eliminating Delays

Operating a system requiring prior approval of rates of necessity creates some delays in the rate-making process. These delays, however, are compounded if rate filings are not acted upon promptly. The Department is not always acting promptly and has delayed some rate filings for years. Further, the Department may not have authority to delay rate filings for excessive periods of time. A move to open competition would eliminate these long delays.

\* A complete text of the opinion is shown in Appendix C.



Even when the Department acts promptly upon a rate filing the approval process can be lengthy, depending upon the depth of the review required. For example, those filings that require an actuarial analysis usually take longer to approve. Currently it takes the Department up to 233 days to approve filings from independent companies and up to 241 days to approve rating bureau filings.

Any delays in rate approvals can have negative effects if they are excessive. The NAIC staff has noted

"In any inflationary situation, delays in granting rate increases can cost insurers substantial sums of money as long as the obsolete rates must be continued. On the other hand, if a decrease is in order, a delay may impair an insurer's competitive position."<sup>8</sup>

Therefore, delays in approving rate filings may serve to work against two of the purposes of rate regulation: insuring solvency and reasonable prices.  
(pages 49 and 51)

Rate filings that are not acted upon promptly by the Department can literally be delayed for years. The Department normally acts promptly upon rate filings from major companies and/or major forms of coverage. However, some filings appear to become "lost" in the process.

8 NAIC report pg. 64.

When the Department receives a non-routine filing it generally sends the companies a "G-122" form letter. This letter informs the company that the department is exercising its right to take an additional 15 days to review the request and the 15 days will begin after the company provides the department with all of the additional data it needs. Until the information is received the filing remains "on hold" in the approval process.

During our review we identified many filings that had been in the approval process for 100 and 200 days. We noted filings that were 539, 722, 1,145 and 1,337 days old. In order to gain more information about some of these filings we contacted a few of the companies which had submitted the filings and found:

- (a) One filing had been approved but not removed from the pending file. (232 days old)
- (b) One company had followed up on its filings three different times but could not get a reply from the Department. The company had since dropped the program but the Department had still retained the filing. (1,337 days old)
- (c) Another company had contacted the Department several times. The company said no additional information had been requested by the Department when it made these contacts so it was waiting for the Department to act. However, the Department was apparently waiting for the company to act because it had retained the filing in the pending files. This company had restricted its underwriting in Arizona due to this delay. (160 days old)
- (d) One company claimed that the Department had been "ambiguous" as to what additional data was required. It was refusing to sell its policy in Arizona because of the delay. (307 days old)

The primary causes for excessive delays appear to be the Department's failure to 1) follow up on it's requests to companies for more information and 2) respond to company communications regarding filings.

It should be noted that the Department has taken action on many of the delays observed during our review. The Department took action on 46 of the filings we reviewed only two days after we discussed the filings with them. The Department approved 29 filings, requested more information on 16 and denied one. The 29 filings that were approved by the Department had been pending an average of 132 days.

The Department may not have the authority to delay review of some rate filings. As noted above, almost all companies submitting filings received "G-122" letters which extend the review periods for 15 days after all additional information is received. This letter is based on the provisions of ARS 20-344 which provide for submission of additional data and 15 days extensions of the review period for property and marine rates. The general counsel of the largest property-casualty company in Arizona recently questioned the validity of using G-122 letter for vehicle, casualty and surety rates. In a letter to the Department dated February 19, 1979, the associate general counsel noted:

"ARS 20-357 contains the filing requirements for 'vehicle, casualty and surety' rates. It provides an initial waiting period of 15 days, but does not have an extension period, nor does it delay the waiting period until such time as the Director has sufficient information to determine whether the filing meets statutory requirements."

Department officials have told us they do not know if the time extensions and delays specified in G-122 letters can be applied to vehicle and casualty rates. They noted however, that companies thus far have not formally challenged the use of G-122 letters. Nevertheless, the possibility does exist that the Department is exceeding its statutory authority and that a challenge of such authority could require the Department to either review all vehicle rates within 15 days or "deem" them approved. It would be extremely difficult for the Department to review these filings in 15 days given that filings often require 30 days or more to review. In order to disapprove any rates "deemed" approved the Department would have to hold hearings. Such a hearing process would be both time consuming and expensive to all parties involved.

#### Reducing Staffing Costs

Adopting an open competition system of rate regulation would eliminate the need for the Division to add additional rate approval staff and would allow present Division staffing levels to be reduced or shifted to other functions.

The present Property-Casualty Division staff of six persons does not include an actuary and is inadequate to review rates without delays. The deputy Director over the Property-Casualty Division estimates it would require the addition of an actuary and two to three other employees at a cost of approximately \$70,000 per year to be able to review all rates within what he believes to be a reasonable time of 30 days\*. These costs can be avoided by moving to open competition because rate review would no longer be required for a majority of the filings currently being received by the Department.

\* 30 days may still not comply with the statutory 15 day review of vehicle and casualty rates discussed above.

In addition, present Division staffing levels could be reduced and/or staff assigned to perform other duties if open competition were adopted. We estimate that the Department annually reviews 7,500 to 8,000 filings.\* Under an open competition system of rate regulation, filings would not have to be approved except for a few special coverages such as workmen's compensation or medical malpractice insurance. We estimate that the elimination of the prior approval system of rate regulation would allow two to three current Division positions to be:

- (a) assigned to perform functions designed to increase competition and public awareness. When Virginia moved to open competition it did not reduce staff. It instead redirected staff efforts towards such activities as the development of consumer brochures and price comparisons.
- (b) assigned to other divisions within the department such as consumer complaints. If greater public knowledge of the availability of consumer complaint services is created (see page 36), some staff might be used to handle the additional complaints that will be received.
- (c) reduced. Such savings would be approximately \$25,000 to \$35,000 per year.

#### CONCLUSIONS

Open competition systems of rate regulation are equally as effective as prior approval systems in achieving the goals of rate regulation: availability, price and solvency. Therefore, prior approval of most rates is not needed.

Adopting an open competition system of rate regulation would 1) remove questions regarding the ability and authority of the department to operate the present rate approval system as it is presently doing 2) eliminate the long delays and possible areas of non-compliance present in the current system 3) forestall the need for additional staff to correct current problems at a possible cost of up to \$70,000, and allow for possible reductions of present staff at a cost of \$30,000. Such savings could jointly total from \$65,000 to \$100,000 per year.

\* Department records show 12,000 filings per year but we discovered filings were being inadvertently double counted placing the actual figures at approximately 7,500.

RECOMMENDATION

We recommend the present prior approval rate regulation law be repealed and replaced with an open competition rate regulation law.

## FINDING VI

THE ARIZONA DEPARTMENT OF INSURANCE NEEDS ADDITIONAL LEGISLATION TO ENABLE IT TO DEVELOP A STRONGER REGULATORY PROGRAM AND TO RECOVER ALL THE COSTS OF COMPANY EXAMINATIONS.

Our review of the Arizona Department of Insurance revealed that there are several regulatory areas that are inadequate and require statutory or procedural changes. These areas are: 1) Arizona has not adopted statutes and regulations relating to unfair claims settlement practices 2) The statutes do not provided the Director of Insurance with the authority to fine companies for infractions of the insurance code and insurance regulations, and 3) the statutes do not currently provide for full recovery of all examination costs as is done by other states.

### Unfair Claims Settlement Statutes

#### And Regulations Are Needed

Arizona has not adopted the provisions of the NAIC sponsored Unfair Trade Practices Act relating to unfair claims settlement practices. Arizona has also not adopted the Unfair Claims Settlement Regulation which is an NAIC Model Regulation derived from the provisions of the Unfair Trade Practices Act. The Unfair Claims Settlement Regulation prohibits insurers doing business in a state from engaging in unfair claims settlement practices. The regulation defines minimum standards which, if violated "...with such frequency as to indicate a general business practice..." are deemed to constitute unfair claims settlement practices. The standards include provisions relating to: misrepresentation of policy provisions, failure to acknowledge communications, and prompt investigation and settlement of claims.

The need for regulation of claims handling is indicated by the fact that 55% of all complaints received by the Department relate to claims handling. By not adopting the provisions of the Unfair Trade Practices Act relating to unfair claims settlement practices, and the accompanying regulation, the State of Arizona lacks needed statutory authority to regulate insurance claims practices. The NAIC reports forty-five states have adopted the statutory provisions of the Unfair Trade Practices Act and nine states have adopted Unfair Claims Settlement Regulations to accompany the statutes.

#### Authority To Fine Companies Is Needed

Currently, the Director of Insurance has no authority to fine companies for violations of insurance statutes other than \$100 fines for late filing of annual statements. As a result, the Director has only two disciplinary options, 1) remove the company's authority to do business in Arizona or, 2) do nothing at all. Department officials believe this lack of disciplinary options restricts the Department's ability to effectively regulate companies because removing a company's authority to do business is such a drastic step both in terms of its effect on the company and its policyholders that most violations must go unpunished.

The NAIC model Unfair Trade Practices Act provides for directors to have authority to order payment of monetary penalties of from \$1,000 to \$5,000 for each violation of the act. Currently 24 states have the authority to fine companies for violations of insurance statutes. A survey by the Office of the Auditor General revealed that 22 of these states do in fact use the authority to fine companies when violations are found.\* The surveyed states reported that they had individually fined as many as 50 companies per year and that the fines had proved to be effective in obtaining company compliance with statutes.

The current lack of authority to fine companies also appears inconsistent with the Director's current authority to fine agents. Presently, ARS 20-316 provides the Director with the authority to fine insurance agents a sum not in excess of one hundred dollars for each failure or violation "...of any law relating to insurance or of any rule, regulation or order promulgated by the director..." Thus, the Director can fine agents but not companies.

\* Another state, Texas, reported it had "monetary penalties" which had the same effect as fines. Pennsylvania reported it used consent orders involving payments of up to \$2,000 in instances where laws or regulations did not provide for fines.



### Authority To Recover All Examination Costs

ARS 20-159 provides for the Department to recover the travel, per diem and living expenses of Department examiners from the companies examined. The statute is silent, however, on recovery of overhead costs such as the Chief Examiner's salary, secretarial support, etc. At least 11 other states have statutes providing for the recovery of all examination costs including overhead expenses. If Arizona had a similar provision more than \$20,000 in overhead expenses would be recovered each year.

### CONCLUSIONS

Our review of the Insurance Department has shown that there are several regulatory areas that are inadequate, in that 1) Arizona has not adopted statutory provisions and regulations pertaining to unfair claims settlement practices, 2) the director can fine only agents not companies, and 3) The Department does not recover all examination costs as is done by other states. As a result the department lacks statutory authority needed to effectively regulate the insurance industry and the Department is failing to recover more than \$20,000 per year in overhead costs.

### RECOMMENDATIONS

1. We recommend that Arizona adopt statutory provisions and regulations pertaining to unfair claims settlement practices. We also recommend that the Director be given statutory authority to fine companies to be consistent with his power to fine agents.
2. We recommend that ARS 20-159 be amended to provide for recovery of all examination costs.

## OTHER PERTINENT INFORMATION

During the course of the audit we identified the following pertinent items relating to: conflict of interest, the exempt classification of the chief examiner, unnecessary hearings held, the absence of a need to license solicitors and an unnecessary requirement for color photographs.

### Conflict of Interest

An employee of the Department of Insurance is receiving renewal commissions from a former employer (an insurance company). These commissions result from continuing life insurance policies which were sold by the employee when he was an agent for the insurer. Although the amounts received have decreased and are now small, such payments violate the conflict of interest provisions of ARS 20-149. In a memo dated March 29, 1979,\* the Arizona Legislative Council reviewed ARS 20-149 and concluded "...any money transaction between an employee of the director and an insurer is prohibited. This would apparently apply to renewal commission fees received from an insurer for past services rendered."

The Director of Insurance told us he was unaware such payments constituted a conflict of interest. He said he would review the matter with the department's assistant Attorney General and then take corrective actions.

### Exempt Classification of the Chief Examiner

The Director of Insurance has received permission from the Personnel Division to exempt the Chief Examiner and three other division directors from the jurisdiction of the Personnel Board. The director has not exempted these positions as of June 1979.

\* A complete text of the Legislative Council's opinion is shown in Appendix C.

We found that the NAIC takes no position on whether the chief examiner should be covered by merit systems. We also found the practice varies among states. In a survey of 25 states we found the chief examiner is covered by merit systems in 18 states and is not covered by merit systems in seven states. Moreover, in four of those seven states not covered by merit systems none of the insurance department employees were covered by merit systems.

#### Unnecessary Hearings

In 1978 the Arizona Insurance Department held 258 formal hearings. This number is significantly higher than the number of hearings held by any of the 30 other states responding to our survey. The two states with the next highest numbers of hearings were Iowa (150) and Illinois (122). The majority of the states held fewer than 50 hearings.

Reviewing the hearings held by the Department we found that 31% of the hearings were held to obtain data from company officials before issuing certificates of authority to do business in Arizona. Only one of the 30 states we contacted held hearings for such purposes, and it does so on an informal basis. The other states use affidavits to obtain the information they desire.

The Department's Assistant Attorney General has advised us that he believes affidavits could be used in most cases to obtain data needed to grant certificates of authority. This would reduce the number of hearings held by the Department by almost one-third. It would also reduce the costs incurred by the company officials who must often travel from out-of-state to appear at the hearings.

### Solicitors' Licenses Are Not Needed

ARS 20-186 provides that insurance agents and brokers may appoint individuals to solicit applications for insurance as representatives of the agent and broker. The agent or broker must file an affidavit with the Insurance Department acknowledging "...responsibility and liability for all transactions under such solicitor's license" and swearing the solicitor will be "officed" with the agent or broker. The solicitor must then be licensed by the Department.

There are few, perhaps four or five, solicitors licensed each year. Such a licensing requirement appears to be unjustified. The Council of State Governments in its publication Occupational Licensing, states:

"There is little justification for licensure if Practitioners work under supervision. If regulation is needed, it should be the supervisor who is regulated."

In the case of solicitors, they work under the supervision of licensed agents and brokers who acknowledge responsibility for the solicitors' actions.

### Requiring Unnecessary Color Photographs

Applicants are required to submit a color photograph with their application for licensure. If photos are not submitted, processing is delayed until the photograph is received. However, the photographs are not needed. The photographs were originally required because the Department had considered putting photographs on the licenses. They have been continued so the Department can use the photographs for identification at the examination, and occasionally in investigating complaints.

We found that the other licensing agencies use driver's licenses for identification at the examinations. Also, the Department can obtain photographs of agents, free of charge, from the driver's license division if a photograph is needed for investigation. Thus, the color photograph requirement is unnecessary and creates additional expenses, delays and inconveniences for applicants.



STATE OF ARIZONA  
DEPARTMENT OF INSURANCE  
REPORT ON EXAMINATION OF FINANCIAL STATEMENTS  
JUNE 30, 1978





STATE OF ARIZONA  
DEPARTMENT OF INSURANCE  
JUNE 30, 1978

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SECTION I  
OPERATING FUNDS





DOUGLAS R. NORTON, CPA  
AUDITOR GENERAL

STATE OF ARIZONA  
OFFICE OF THE  
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA  
DEPUTY AUDITOR GENERAL

AUDITORS' OPINION

The Joint Legislative Budget Committee of  
The Arizona State Legislature

We have examined the financial statements of the General and Examiners Funds and the General Fixed Assets group of accounts of the State of Arizona, Department of Insurance as of June 30, 1978, listed in the foregoing table of contents. Except as set forth in the following paragraph, our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Evidence supporting the cost of office furniture and equipment acquired prior to June 30, 1970, is no longer available. The Department's records do not permit the application of adequate alternative procedures regarding the cost of office furniture and equipment. Because we were unable to satisfy ourselves as a result of such incomplete records, we are unable to express, and we do not express an opinion on the accompanying financial statement of the General Fixed Assets group of accounts.

In our opinion, the financial statements referred to above present fairly the financial position of the General and Examiners Funds of the State of Arizona, Department of Insurance at June 30, 1978, and the results of operations of such funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

December 21, 1978

Douglas R. Norton  
Auditor General



STATE OF ARIZONA  
DEPARTMENT OF INSURANCE  
OPERATING FUNDS  
BALANCE SHEET  
JUNE 30, 1978

	<u>General</u>	<u>Examiners</u>	<u>General Fixed Assets</u>
<u>ASSETS</u>			
Funds on deposit with State Treasurer	\$25,349	\$ 51,485	
Investments (Note 2)		60,000	
Reimbursements receivable		35,805	
General fixed assets:			
Office furniture and equipment			\$88,063
	<u>\$25,349</u>	<u>\$147,290</u>	<u>\$88,063</u>
<u>LIABILITIES AND FUND BALANCE</u>			
Accounts payable	\$25,349	\$ 14,006	
Contingent liabilities (Note 3)			
Investment in general fixed assets			\$88,063
Fund balance		133,284	
	<u>\$25,349</u>	<u>\$147,290</u>	<u>\$88,063</u>

The accompanying notes to financial statements  
 are an integral part of this statement.

STATE OF ARIZONA  
DEPARTMENT OF INSURANCE  
OPERATING FUNDS  
REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE  
YEAR ENDED JUNE 30, 1978

	<u>General</u>	<u>Examiners</u>
Revenues:		
Legislative appropriations	\$1,116,000	
Assessments		\$ 45,900
Reimbursements		529,139
Interest on investments		1,706
Total revenues	<u>1,116,000</u>	<u>576,745</u>
Expenditures:		
Personal services	728,939	
Employee related costs	128,954	
Professional and outside services	74,883	398,734
Travel	6,478	148,898
Rental	75,472	
Other	67,635	
Capital outlay	5,911	
Total expenditures	<u>1,088,272</u>	<u>547,632</u>
Refunds of assessments		<u>2,129</u>
Total expenditures and refunds		<u>549,761</u>
Excess of revenues over expenditures and refunds	27,728	26,984
Reversion to State General Fund	<u>(27,728)</u>	<u>          </u>
Increase in fund balance	-0-	26,984
Fund balance, July 1, 1977	<u>-0-</u>	<u>106,300</u>
Fund balance, June 30, 1978	<u>\$ -0-</u>	<u>\$133,284</u>

The accompanying notes to financial statements  
 are an integral part of this statement.



STATE OF ARIZONA  
DEPARTMENT OF INSURANCE  
OPERATING FUNDS  
BUDGET AND ACTUAL EXPENDITURES - GENERAL  
YEAR ENDED JUNE 30, 1978

	<u>Budget</u>	<u>Actual</u>	<u>Actual (Over) Under Budget</u>
Personal services	\$ 735,000	\$ 728,939	\$ 6,061
Employee related costs	142,800	128,954	13,846
Professional and outside services	77,400	74,883	2,517
Travel - state	4,400	3,122	1,278
Travel - out-of-state	4,300	3,356	944
Other operating	146,000	143,107	2,893
Capital outlay	<u>6,100</u>	<u>5,911</u>	<u>189</u>
Total expenditures	<u>\$1,116,000</u>	<u>\$1,088,272</u>	<u>\$27,728</u>

The accompanying notes to financial statements  
 are an integral part of this statement.

STATE OF ARIZONA  
DEPARTMENT OF INSURANCE  
OPERATING FUNDS  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 1978

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting - The financial statements of the General and Examiners funds and the General Fixed Assets group of accounts have been prepared in accordance with the principles of fund accounting. According to these principles, revenues, assets, expenditures and liabilities are segregated into funds according to purpose or function.

The financial statements are presented on the modified accrual basis of accounting. Under the modified accrual basis, revenues are recorded when collected except for revenues susceptible to accrual and revenues of a material amount that have not been received at the normal time of receipt. Expenditures are recorded on the accrual basis except for prepaid and inventory items which are recorded as expenditures at the time of purchase.

General Fixed Assets - Assets capitalized in the General Fixed Assets group of accounts are recorded at the time of purchase as expenditures in the General Fund. No depreciation has been provided for general fixed assets.

NOTE 2 - INVESTMENTS

Investments, which consist of Time Certificates of Deposit, are made on behalf of the Department by the State Treasurer.

NOTE 3 - CONTINGENT LIABILITIES

Employees of the Department may accrue vacation time and sick leave based upon length of service. Upon termination of employment, an employee is paid unused vacation time, but forfeits unused sick leave. As of June 30, 1978, the following amounts had been accumulated:

Vacation time	6,101	hours
Sick leave	<u>9,833</u>	hours
	<u>15,934</u>	hours

STATE OF ARIZONA  
DEPARTMENT OF INSURANCE  
OPERATING FUNDS  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 1978

NOTE 4 - RETIREMENT PLANS

All permanent full-time employees of the Department of Insurance are covered by a retirement plan administered by the State of Arizona. The plan is funded through mandatory payroll deductions from covered employees' gross earnings and from amounts contributed by the Department of Insurance. Retirement payments are obligations of the State retirement plan. For the year ended June 30, 1978, Department of Insurance contributions to the State retirement plan amounted to \$48,413.



SECTION II  
TRUST FUNDS





DOUGLAS R. NORTON, CPA  
AUDITOR GENERAL

STATE OF ARIZONA  
OFFICE OF THE  
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA  
DEPUTY AUDITOR GENERAL

AUDITORS' OPINION

The Joint Legislative Budget Committee of  
The Arizona State Legislature

We have examined the financial statements of the Trust Funds of the State of Arizona, Department of Insurance as of June 30, 1978, listed in the foregoing table of contents. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The statements of the Trust Funds, listed in the foregoing table of contents, do not give effect to accounts receivable, accounts payable, and accrued items. Accordingly, the statements do not present financial position and results of operations in conformity with generally accepted accounting principles.

In our opinion, the accompanying financial statements present fairly the assets and liabilities arising from cash transactions of the Trust Funds of the State of Arizona, Department of Insurance at June 30, 1978, and the receipts, disbursements, and changes in cash balance for the year then ended, on a basis consistent with that of the preceding year.

December 21, 1978

*Douglas R. Norton*  
Douglas R. Norton  
Auditor General





STATE OF ARIZONA  
DEPARTMENT OF INSURANCE  
TRUST FUNDS  
ASSETS AND LIABILITIES ARISING FROM CASH TRANSACTIONS  
JUNE 30, 1978

	<u>Joint Underwriting Plan</u>
<u>ASSETS</u>	
Funds on deposit with State Treasurer	\$3,699,290
	<u>\$3,699,290</u>
<u>FUND BALANCE</u>	
Fund balance	\$3,699,290
	<u>\$3,699,290</u>

The accompanying notes to financial statements  
are an integral part of this statement.

STATE OF ARIZONA  
DEPARTMENT OF INSURANCE  
TRUST FUNDS  
RECEIPTS, DISBURSEMENTS AND CHANGES IN CASH BALANCE  
YEAR ENDED JUNE 30, 1978

	<u>Premium Tax Clearing</u>	<u>Joint Underwriting Plan</u>
Receipts:		
Insurance premiums		\$1,931,725
Interest on investments		161,928
Premium taxes	\$29,720,637	
Licenses	711,706	
Fees	780,116	
Fines, forfeitures and penalties	40,062	
Miscellaneous	13,080	
Total receipts	<u>31,265,601</u>	<u>2,093,653</u>
Disbursements:		
Professional and outside services		189,776
Other		20
Total disbursements		<u>189,796</u>
Refunds:		
Premium tax	195,295	
Insurance premiums		49,760
Transfers out:		
State General Fund	23,639,813	
Fireman's Relief and Pension	1,247,847	
Industrial Commission Administrative Fund	2,980,247	
Law Enforcement Retirement System	1,657,435	
Total transfers out	<u>29,525,342</u>	
Total disbursements, refunds and transfers	<u>29,720,637</u>	<u>239,556</u>
Excess receipts over disbursements, refunds and transfers	1,544,964	1,854,097
Remittance to State General Fund	<u>(1,544,964)</u>	
Increase in cash balance	-0-	1,854,097
Cash balance, July 1, 1977	<u>-0-</u>	<u>1,845,193</u>
Cash balance, June 30, 1978	<u>\$ -0-</u>	<u>\$3,699,290</u>

The accompanying notes to financial statements  
are an integral part of this statement.

STATE OF ARIZONA  
DEPARTMENT OF INSURANCE  
TRUST FUNDS  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 1978

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting - The financial statements of the Joint Underwriting Plan and Premium Tax Clearing funds have been prepared in accordance with the principles of fund accounting. According to these principles, revenues, assets, expenditures and liabilities are segregated into funds according to purpose or function.

The financial statements are presented on the cash basis of accounting.

NOTE 2 - INSURER'S SECURITIES HELD IN TRUST

The State Treasurer holds in trust, for the Director of the Department of Insurance, security deposits as required to transact insurance business in the State of Arizona. The securities consist of obligations of the United States Government, and of states, territories, counties, municipalities, school districts, savings and loan associations, and banking institutions. On June 30, 1978, the State Treasurer held security deposits in trust in the amount of \$91,294,882 stated at face value.



STATE OF ARIZONA  
DEPARTMENT OF INSURANCE  
LETTER OF RECOMMENDATIONS  
MARCH 1979





STATE OF ARIZONA  
OFFICE OF THE  
AUDITOR GENERAL

DOUGLAS R. NORTON, CPA  
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA  
DEPUTY AUDITOR GENERAL

March 8, 1979

Mr. John N. Trimble, Director  
Department of Insurance  
1601 W. Jefferson  
Phoenix, AZ 85007

Dear Mr. Trimble:

We have examined the financial statements of the State of Arizona Department of Insurance for the year ended June 30, 1978, and have issued our report thereon dated December 21, 1978. As a part of our examination, we reviewed and tested the Department's system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards. Under these standards, the purpose of such evaluation is to establish a basis for reliance thereon in determining the nature, timing and extent of other auditing procedures that are necessary for expressing an opinion on the financial statements.

The objective of internal accounting control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

Mr. John N. Trimble, Director  
Department of Insurance  
March 8, 1979  
Page Two

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal accounting control. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management with respect either to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate.

Our study and evaluation of the Department's system of internal accounting control for the year ended June 30, 1978, which was made for the purpose set forth in the first paragraph, would not necessarily disclose all weaknesses in the system. However, such study and evaluation disclosed certain conditions that we believe could be improved by implementation of the following recommendations.

#### LICENSING PROCESS

The Department is currently attempting to automate the process of licensing insurance carriers and agents in the State. The present method of licensing is antiquated and cumbersome.

The Department should continue its efforts towards completion of this project. We also feel that the Department should consider the automation of the review process for premium tax collections. We support the efforts of the Department and feel that these projects are essential in order to operate and manage the Department in a more efficient manner.



Mr. John N. Trimble, Director  
Department of Insurance  
March 8, 1979  
Page Three

#### SEGREGATION OF DUTIES

1. One person makes disbursements from the Administrative Service Division's revolving fund, initiates reimbursements to the account and reconciles the bank statement.

The Administrative Services Division should separate the disbursing and reconciling duties.

2. Two employees share responsibility for all phases of personnel and payroll functions, including initiating, picking up and distributing payroll warrants.

Payroll and personnel duties should be segregated. Also, an employee with no payroll-related function should be responsible for picking up and distributing payroll warrants.

#### RECEIPTS

The current cash register does not total accurately when amounts exceeding \$800,000 are entered.

To better control receipts, the Department should consider the purchase of a new cash register, with capacity adequate to handle the large sums of money often handled by the Department.

#### DISBURSEMENTS

At the beginning of fiscal years 1977-78 and 1978-79, expenditures were made from General Fund appropriated money for expenses applicable to the previous fiscal year.

Mr. John N. Trimble, Director  
Department of Insurance  
March 8, 1979  
Page Four


To comply with Arizona Revised Statute 35-190-C, expenses applicable to a prior fiscal year must not be made from funds appropriated for the current fiscal year. Such amounts should be encumbered at year-end, or paid via General Relief Bill or Administrative Adjustment. This would allow recording of expenses within the prior fiscal year.

JOINT UNDERWRITING PLAN FUND

The financial activity is not closed out to fund balance at the end of each fiscal year.

Receipts and disbursements for the Joint Underwriting Plan Fund should be closed out to fund balance at the end of each fiscal year, and only the resulting fund balance carried forward to the subsequent year, in order to reflect results of operations for the current year.

Should you have any questions regarding these recommendations, we shall be pleased to discuss them with you.

  
Douglas R. Norton  
Auditor General



BRUCE BABBITT  
GOVERNOR

STATE OF ARIZONA  
DEPARTMENT OF INSURANCE

JACK TRIMBLE, CPCU  
DIRECTOR OF INSURANCE

1601 WEST JEFFERSON  
PHOENIX, ARIZONA 85007

July 24, 1979

Response by the Department of Insurance to the Performance Audit Report on the Arizona Department of Insurance by the Office of the Auditor General.

SUMMARY

Page 1, paragraph 2 - Number of employees.

Report indicates 58 full time employees. J.L.B.C. shows:

	<u>1977-78</u>	<u>1978-79</u>	<u>1979-80</u>
Number of F.T.E. positions	Actual 60.7	Estimate 60.7	64.7

The discrepancy may be due to some job turnover and the fact that 2.7 employees are classified as seasonal or summer aides.

Defer comments on the remainder to the Findings portions.

INTRODUCTION & BACKGROUND

Table 1 - The Department is organized into five (5) divisions, not seven (7), excluding the Director's office and the Tucson office which comes under the Consumer Affairs Division.

FINDING I

Concur with Finding. The question of quarterly premium tax payments was previously addressed by the Department several years ago, but met with such heavy industry opposition it was never presented to the Legislature in bill form. Further, it would seem to make sense for both domestic and foreign insurers to file returns on the same dates during the year rather than dates one month apart as is now the case.

## FINDING II

### LICENSING PROCEDURES

Of the areas where the Department has had and continues to have great concerns, it is in the area of agents & brokers licensing. The area has been studied for over three years and in the last session of the Legislature an important piece of legislation was passed that has not been included in the report, enabling legislation to allow the Department to contract with an outside contractor to administer license examinations.

Another element not included in the Findings is an evaluation of the effectiveness of licensing agents and brokers in the first place.

Question: Is the law protecting the public effectively?

This large question has been left unaddressed.

### Fingerprinting

The policy of this Department is and continues to be that a license will not be issued to an applicant for agents, etc. licenses until a minimal FBI background investigation is completed. The report indicates the program has been somewhat effective. While there may be delays in issuing licenses because of the background check, we seem to be able to head off at least some of the nefarious persons trying to enter the business of insurance in this state before they become licensed. It seems that a one and one-half month's delay, if the figures included on Page 20 of the report are correct, (it appears performance in this area has improved since the Auditors' review) is a small price for an applicant to pay for receiving an occupational license that allows the licensee to deal with the financial security of consumers as well as oftentimes becoming a fiduciary. Additionally, the process gives the applicant ample time to study for the examination required. The time it takes to secure other occupational licenses should also be considered. An authoritative source within the Real Estate Department indicates that the average elapsed time from date of application to date of issue is approximately ninety days in that agency.

It also appears that a major point has been missed. One of this Department's charges is to regulate licensees to the benefit of the other citizens of this state. This is what is being attempted in the current fingerprinting policy. While it is true that the fingerprinting policy can be inconvenient, it is somewhat analogous to the screening apparatus required in airports that check for weapons and bombs. The policy perhaps can prevent future tragedy, plus being effective in the enforcement of the law.

Fingerprinting of applicants began in 1967 in this Department and has been continuous since that time. It is interesting to note that submissions from law enforcement agencies are also accepted and it is perceived that a larger percentage of unreadable prints returned are from those agencies as opposed to the Department's activity. Further, the Real Estate Department had a lapse of several years in their printing because of budget and other problems, the Department of Insurance has not. The 20% return factor is questionable.

While there is no objection to having an outside service perform fingerprinting, it has been a matter of priority and some legislative action might be necessary to accomplish this goal.

#### "Over the Counter" Screening

Concur, except it should be noted that all documents necessary are not usually present at an "Over the Counter" interview, i.e., company appointments. The absence of these documents largely caused the delays expressed. The passage of S.B. 1195 has eliminated insurer appointments of agents and permits easier "Over the Counter" screening.

Also, there is some confusion in the report as to the proportion of applicants that actually bring their applications in to the Department for submission. Many applicants pick up applications at the time of fingerprinting, complete at a later date and return by mail. The proportion of completed applications actually hand delivered to the Department is estimated to be 25% by the license section.

#### Realign Key Employee Functions

This item will largely be resolved with the employment of E.T.S. (Educational Testing Service) as the contractor to administer examinations. The target date for implementation of the E.T.S. system is November 1, 1979. Further, computer terminals within the Department are in the process of being contracted for and should be on line around January 1, 1980.

When these systems are on line a reassignment of duties will take place. It is interesting to note, however, that studies of the section by state employed consultants have indicated that the license process should be followed all the way through by one clerk rather than fragmenting the procedure by assigning different persons to different tasks within the process.

#### Improve Telephone Procedures

Many of these problems have been resolved since the new license section supervisor has taken hold. Still, the telephone continues to be a problem throughout the Department. Studies have previously been made by the telephone company and state consultants without much success. Hopefully, with the new examinations and computer systems the problem can at least be partially solved in the license section.

#### Use of Computer to Type & Mail Licenses

Until new computer terminals are installed, computer typing of licenses will create additional delays in the process because the source document currently must be prepared in any event within the existing system, then an additional delay of two, three days or longer to key punch, process and mail. The practice of typing a salutation on the congratulatory printed letter has been discontinued. (The letter is actually an admonition for continuing education).

#### Video Terminals

Terminals should be on line by January 1980.

#### Testing

E.T.S. was contracted with in June 1979. The E.T.S. program will be on line by November 1979.

However, on Page 27, third dash - the major exams, life and disability and property and casualty were revised January 1, 1977 and August 1976 respectively, and were under revision again while the Auditor General was in the Department. It also should be noted that before 1976 the major exams had not been revised for up to ten (10) years or longer. Further, it takes several months to implement a new exam under the current system.

In any event, most of the testing problems should be eliminated with the implementation of the E.T.S. system.

#### Pool Employees

The practice indicated in the report, at least for the last two years, has been caused largely by the conversion from a manual to a computer system. It was not felt that the system could be shut down for a year during conversion, as what reportedly happened when other departments converted. Also, the report failed to note 2.7 F.T.E.'s as indicated on Page 1 have been included within the Department's budget as seasonal or summer aides, therefore, the use

of pool persons was not entirely outside of legislative intent.

### CONCLUSION

While the license section is still by no means perfect, definite improvements have been made since November 1978, with the addition of a new supervisor and a reduction in employee turnover. Hopefully, with the new computer terminals, the E.T.S. program and elimination of company appointments of agents, the situation can be mitigated considerably.

### FINDING III

It is true the Department needs to take a higher profile in the public awareness area. The problem really boils down into two areas: funding and personnel.

However, it is rather interesting to note the number of complaints closed by the Department has increased from 2,996, calendar year 1975 to 4,822, calendar year 1978. Obviously, an increase of 61% in complaints within a three-year period indicates some additional consumer awareness of the services offered by this Department. This has been done with no increase in staff in the consumer services section. Further, the Department is not really concerned through whom complaints are channeled. On balance, it should be considered that the agencies mentioned under "People Don't Know Where to Complain" on Page 34 of the report are supposed to be largely consumer oriented and it should be part of their function to channel uninformed consumers to the proper agency where they can be helped. Also, if as many as 80% of consumers who do call know where to call with problems as indicated in the report, perhaps that is not too bad a percentage and could prove that "word of mouth" is a fairly effective communicator.

It should be further noted that this Department is not a news media organization. The staff is not trained in this area and certainly not paid for the function. However, during fiscal year 1978, more than 35 separate articles have appeared in the "Arizona Republic" alone, relating to Department of Insurance activities, with considerable other news media exposure during the year. Within the last three years the Department has had a considerably higher profile than ever before in its history. This activity naturally has led to higher consumer awareness.

While it is agreed there is a need to have a better informed insurance consuming public, it is a difficult process - difficult to secure press and media coverage, expensive and time consuming to produce speeches, news releases, television and radio spots, especially without the professional help many departments can afford. To improve this situation, resources must be correspond-

ingly increased. Further, it is somewhat difficult to speak in forums where invitations have not been tendered.

Operation "A.I.D.S." (Arizona Insurance Department Services) was the first organized attempt of the Department in the consumer awareness area and initially occurred in 1978. The plan was to send investigators personally in an effort to help consumers in to each of the county seats other than Maricopa and Pima, along with attending press and radio releases. This was accomplished basically on two separate occasions in calendar year 1978, and was designed for the non-metropolitan counties whose citizens have a more difficult time in communicating with the Department. It is planned to continue this effort in the 1980 fiscal year.

Additionally, in the past there has been an effort to secure budgetary funding for the implementation of a consumer toll free "hot line" into the Department, offering a needed consumer service. This effort did not succeed in passing through the budgetary process and was not mentioned in the report.

#### Greater Use of Complaint Data

There is no question that greater use of complaint data should be made. The report, however, fails to note that complaint data was computerized for the first time in calendar year 1978 and continues in 1979, utilizing the N.A.I.C. model complaint form that has been in use for several years. The information is now in the data base and the goal of this effort is to make greater use of complaint data. Where difficulties have arisen for retrieving this data in the form necessary to make the determinations outlined in the report comes from funding. The Department simply ran out of money to fund the necessary programming to retrieve the information necessary to implement such a program in fiscal 1979. Hopefully, this can be done in fiscal 1980 and the 1979 information retrieved. The goals of the new complaint handling program are echoed in the report.

Further, Table 9 does not make any sense as the maximum number of complaints received on any one insurer in 1978 was 315. There could be some mathematical machinations used for the figures shown, but they are not explained. Further, the analysis in the report is solely based on quantitative data without regard to quality. An insurer or other person, for example, could receive several minor complaints against them of a varying nature - some justified, unjustified or questionable, and not become the subject of a hearing. Whereas, one or two complaints of major magnitude such as fraud or other areas criminal in nature could trigger a revocation hearing.

The report, further, neglects to mention the manual "flash alert"



card system applying to the monitoring of agents' activities that has been in use within the consumer services section for some time.

#### FINDING IV

The question of consumer brochures has been confined largely due to budgetary restrictions, staff time, and journalistic expertise. Further, such brochures become dated rapidly and should be revised and monitored constantly to make certain the information contained is current.

The Pennsylvania example is interesting as that state has been the leader in producing such brochures over the years. First, of the forty brochures produced since 1971, according to Appendix A, only five have been amended or produced since the end of 1975, which indicates many of these brochures are out of date. Second, the Pennsylvania Department's budget for 1978 was \$5.3 million, as compared with \$1.1 million for Arizona. Arizona has approximately 61 Department employees; Pennsylvania has 232. Although the difference in population between the two states must be considered, there is still a considerable difference between the states in resources. This difference largely tells the tale.

Preliminary efforts have been made in developing these somewhat valuable consumer aids, such as gathering materials from other states and conferring with experts in the area. However, the resource problem has shelved production, at least temporarily. Further, A.R.S. 39-121.03, if strictly interpreted, could impose an insurmountable barrier in the distribution of such materials to consumers.

On the subject of readability, some exception is taken to the comments and recommendations made in the report. Nationwide, Arizona is considered a leader on the subject. The statutory requirements and legislative intent of A.R.S. 20-1110.01 were met by the adoption of Rule R4-14-212. While the N.A.I.C. did adopt the "Life and Health Insurance Policy Language Simplification Model Act" in June of 1978, a restatement of the Act was made and adopted at the December 1978 meeting. Additionally, to this writing, no state has passed the model act. Currently, an effort is being made within the Department to conform the model statute into language that will be suitable as a rule or regulation. Hearings on the adoption of a life and disability readability rule will probably be held in late summer or early fall of 1979. It should also be noted that this Department is represented on the "Uniform Policy Provision Language" task force of the N.A.I.C. relating to property and casualty policy simplification. When the work product of this task force is completed and adopted by the N.A.I.C., undoubtedly Rule R4-212 will be amended for uniformity purposes.

## Public Involvement

(Please note attached article, June 29, 1979 issue of the National Underwriter).

Relating to advisory committees, the Department has had at least three advisory committees within the last three years and currently has one functioning relating to agents, brokers and adjusters' licensing. In the Director's office is a prepared plan for the establishment of a consumer-industry advisory committee. The committee has not as yet been formed due to time constraints and priority. Also, there is no statutory provision for forming such an advisory committee.

## FINDING V

### PRIOR APPROVAL OF PROPERTY-CASUALTY RATES

The total gist of this Finding relates to the elimination of the present system of "prior approval" for property and casualty rates and substituting it with an "open competition" rating system. While the Department has no objections to an "open competition" rating law being enacted in this state, the report has not brought out the differences in various rating laws that are often characterized generically as "open competition" rate laws.

Basically, there are three separate types of "open competition" rating laws, not including the Illinois situation where no rate regulation law exists at all.

They are:

1. File & Use
2. Use & File
3. No File

Both "file and use" and "use and file" are similar. "File and use" means that a rate filing must be filed with the regulatory agency before it can be used, but once the filing is made approval is not needed before it is used or implemented. "Use and file" means that rates can be used before filing, but must be filed with the regulatory agency within a certain specified time period, normally thirty days.

"No file" means exactly that. Rates can be used without any filing with the regulatory agency. Five states currently utilize this system or some modification of it. The other twelve states that have enacted "open competition" laws use one of the first two categories or some variation of them. In some areas of insurance all states still require some form of prior approval (i.e., workmen's compensation), or as in the example of New York which recently

exempted private passenger automobile insurance from its "use and file" law reverting in this area to prior approval.

Even with these systems in place, the basic caveats of rate regulation still apply; i.e., rates cannot be "excessive, inadequate or unfairly discriminatory". Therefore, either a rate review procedure similar to those used in prior approval performed after the fact in the cases of "file and use" or "use and file", or the creation of a massive market surveillance system in the case of "no file" would be required in order to meet the above standards or caveats. Either way, it is not perceived that any massive savings can be achieved through the implementation of an "open competition rate law. In every case except in six states, rates continue to be filed and even in "no file" states, massive market surveillance systems exist. Further, it seems that to achieve what the report recommends would indicate that the state should have no rating law at all.

The N.A.I.C. is currently examining an exposure draft of a new alternative model "open competition" rating law that was received at the June 1979 N.A.I.C. meeting. The new model is still under study and revision, but should be ready for final adoption in the near future. The exposure draft makes crystal clear that if there is a competitive market, a rate used in that market may be disapproved only on the basis that it is unfairly discriminatory or inadequate. While competition may very well solve the question of excessiveness, the questions of unfair discrimination and adequacy remain a regulatory problem.

As a matter of fact, the Director currently has the authority under A.R.S. 20-357E. to suspend or modify the requirement of filing as to any kind of insurance except professional liability insurance. Medical malpractice rate filing requirements were suspended from 1971 to 1976, when H.B. 2001 of the 1976 session prohibited such suspension. From this and from the fact the following "open competition" bills were introduced and not passed by the Legislature since 1973:

1974 - H.B. 2311  
1975 - H.B. 2176  
1976 - H.B. 2400  
1977 - H.B. 2270

would lead the Department to believe that suspension or modification of filing requirements would be against legislative intent.

Additionally, Professor C. Arthur Williams, Sr., Dean of the College of Business Administration of the University of Minnesota, noted expert on competition and profitability in the business of insurance, has predicted that there will be little additional movement toward open competition rate laws for the remainder of this century because of the consumer perception that property and casualty rates should be controlled.

All this notwithstanding, the Department's view is that competition is the best regulator of insurance rates in most instances. Admittedly, the Department's rate approval process is not perfect; however, it is perceived that the vast majority of insurers operating in the property and casualty field in this state feel they receive fair treatment in the handling of their rate filings. On the other hand, the report has taken an isolated case involving not more than 100 filings out of some 7,500 per year to prove the case for "open competition". There are delays in approvals basically because of staff limitations. Significantly, the Department's budget for fiscal 1979-80 includes funding for an on staff actuary for the first time within memory.

The current system of rate approvals has its problems. However, the system works fairly satisfactorily in practice. Although delays do occur, in not one instance within recall has it affected the solvency or solidity of any carrier. From a practical standpoint, largely the handling of filings is currently resolved at a lower level than the administrative hearing process which would create the need for additional resources and undoubtedly massively slow down the process even further.

The G-122 letter has been used for a number of years and in only one instance within recall has a carrier objected to it. However, no insurer has ever made an issue of its legality or deemed a filing approved without prior approval.

A new suspense system has been instituted in the division, ticklering filings at fifteen-day intervals. This system has been in the works for some time and finally developed. Additionally, an index card system has been developed to give daily information on the status of filings. Also, an annual index has been kept for some time on personal lines property and casualty insurance to make certain filings of insurers keep abreast of economic trends.

The conclusion that passage of an "open competition" statute will save the state large sums of money and staff is believed to be fallacious.

## FINDING VI

### UNFAIR CLAIMS SETTLEMENT ACT

Concur. It should be noted that Arizona has passed statutes based upon the N.A.I.C. Model Act relating to unfair methods of competition and unfair and deceptive acts and practices in the business of insurance.

### AUTHORITY TO FINE COMPANIES

Note: The Arizona Legislature did not pass H.B. 2092, "Prescribing Civil Penalty of Violation of the Insurance Code", in the 1977 session.

It has been suggested by a member of the Attorney General's staff that these fines, if ever statutorily authorized, be placed into a special revolving fund for the purposes of special investigations of insurers, agents and brokers where criminal activity is suspected and outside independent experts are needed. This, of course, would include necessary safeguards and spending limitations, plus reversion to the general fund when the fund reached a certain amount. (Similar to a fund the State Banking Department now has in existence).

#### AUTHORITY TO RECOVER ALL EXAMINATION COSTS

Concur.

#### OTHER PERTINENT INFORMATION

##### Conflict of Interest

The problem as mentioned has been corrected upon advice from the Attorney General's office.

##### Exempt Chief Examiner

Speaks for itself.

##### Unnecessary Hearings

Strongly disagree with the conclusion. After fighting for over three years to develop a stronger regulatory atmosphere in this state with some success, this conclusion would be a giant step backward. Even though the Assistant Attorney General mentioned believes much of the information needed could be and is handled through use of affidavits, he also believes there is some value in these hearings. In the Department's view there is no substitute for an "eyeball to eyeball" confrontation with the persons operating an insurance company desiring to do business in this state. Placing those persons under oath and asking the hard questions, at least in part, has put the gangsters and crooks sometimes associated with the business of insurance, on notice to keep out of Arizona. In addition, other states have not had the problems Arizona has had in this area. If the Department can keep one rip-off artist out of the state through this process the price is more than worth it to consumers who could be perhaps bilked of millions.

Even though many of the hearings may be perfunctory, it is still believed to be of great salutary value. This also appears to be a Catch 22 situation - the Department is criticized for not conducting enough hearings on one side (rate hearings), and then

criticized in this area of critical consumer interest of conducting too many. Fortunately for the Auditor General's office it never has to answer the question, "How could you have ever allowed a company like that to operate in this state?"

#### Solicitors Licenses

Concur.

#### Requiring Color Photographs

Concur.

### CONCLUSION

While this report has made some significant points, most of the recommendations have been already addressed by this Department, or it is at least aware of them. The Legislature may find it of value in their deliberations; however, there are several points that have not been brought out in the report that perhaps should be. Some of these points are as follows wherein the Department could use some assistance and recommendations:

1. Examiners' remuneration.
2. Benefit of the triannual examination of insurers.
3. Funding of personnel training.
4. Acceptance of C.P.A. certified audits in lieu of Department financial examinations.
5. Staff counsel for the Department.
6. Use of independent administrative law judges in lieu of Department employed hearing officers.
7. Improvement and training in the market surveillance area.
8. The overall updating and recodifying of A.R.S. Title 20.

The Department also has been limited in attempting to initiate new programs that could aid and assist Arizona policyholders. First, budgets are prioritized and properly so. However, statutory functions must correspondingly take precedence over non-statutory ones. (Example: There is no provision in the statutes for consumer services, i.e., complaint handling, and this service

would necessarily be one of the first functions to be eliminated should budgets be reduced.) Second, in the past, budget instructions have required that only "current levels of service be maintained". This policy has, of course, restricted the initiation of new programs many of which have been recommended in this report.

Notice should also be given to the fact that programs and improvements are not developed overnight. It takes time to correct problems, as it does to perform audits. (Note: This audit was commenced around November 1, 1978, and the draft of the report was delivered to the Department on July 3, 1979.

## ***Pa. Department Names Ross Press Secretary***

**By National Underwriter Correspondent**

**HARRISBURG, Pa.**—The appointment of Andrew Ross, former reporter for the Norristown Times Herald, as press secretary for the Pennsylvania department has been announced by Commissioner Harvey Bartle III.

Mr. Ross has been with the Norristown newspaper since 1977. He is a member of the Pennsylvania Bar Assn.

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*The National Underwriter*, June 29, 1979



APPENDICES



APPENDIX A

CONSUMER BROCHURES PUBLISHED BY  
THE PENNSYLVANIA INSURANCE DEPARTMENT

After the Flood: Handbook on Salvage and Insurance, June 1972  
Revised editions, September 1975, July 1977 and February 1978

Bill of Rights Series, March 1974

Citizens Bill of Hospital Rights, April 1973

Citizen's Bill of Rights and Consumer's Guide to Nuclear Power, September 1973

Consumer's Guide to Understanding Pensions, January 1974

Consumers Report to the People of Pennsylvania, 1971-1972

Facts you Should Know About Pennsylvania's Auto Insurance Law, January 1974

Flood Insurance Facts, February 1977  
Revised edition, February 1978

How to Save Money on Your Automobile Insurance, July 1977

How to Spot Insurance Rip-offs: Thirty Dirty Tricks Forbidden by  
Pennsylvania Law, December 1974

Insurance Commissioner's Advisory Task Force on Women's Insurance  
Problems - Final Report and Recommendations, June 1974

Mini Guide to Industrial Life Insurance, January 1974

Mini Guide to Women's Insurance Rights, March 1974

Mini Guide to Yearly Renewable Term Life Insurance, February 1974

Motorist's Guide Through No-Fault, July 1973

No-Fault and You, May 1975

Philadelphia Inner-city Insurance Complaint Program, June 1975

Shopper's Guides - Page 2

Rate Your Dentist, May 1973

Rate Your Life and Health Insurance Agent, August 1973

Rate Your Property-Liability Insurance Agent, August 1973

Shopper's Guide to Automobile Insurance Complaints, December 1975

Shopper's Guide to Dentistry, February 1973

Shopper's Guide to Financially Strong Insurance Companies, September 1973

Shopper's Guide to Homeowner's Insurance, March 1974

Shopper's Guide to Hospitals in the Philadelphia Area, November 1971

Shopper's Guide to Insurance - A Series of Tips on How to Shop and Save on Insurance, October 1973

Shopper's Guide to Health Insurance, December 1973

Shopper's Guide to Insurance on Mobile Homes, January 1973

Shopper's Guide to Insurance on Snowmobiles, November 1973

Shopper's Guide to Lawyers, January 1974

Shopper's Guide to Life Insurance, April 1972

Shopper's Guide to No-Fault Insurance Rates - Eastern PA edition, November 1975

Shopper's Guide to No-Fault Insurance Rates - Western PA edition, November 1975

Shopper's Guide to Pennsylvania Automobile Insurance, April 1972

Shopper's Guide to Resolving Insurance Complaints, October 1974

Shopper's Guide to Straight Life Insurance (Second edition), June 1973

Shopper's Guide to Surgery, July 1972

Shopper's Guide to Term Life Insurance, December 1972

Sixteen Insurance Tips for Farmers, March 1974

APPENDIX B

LIFE INSURANCE BUYER'S GUIDE  
DEVELOPED BY THE NATIONAL  
ASSOCIATION OF INSURANCE COMMISSIONERS (NAIC)



## APPENDIX B

### Life Insurance Buyer's Guide

This guide can show you how to save money when you shop for life insurance. It helps you to:

- Decide how much life insurance you should buy.
- Decide what kind of life insurance policy you need, and
- Compare the cost of similar life insurance policies.

Prepared by the National Association of Insurance Commissioners

Reprinted by (Company Name)  
(Month and year of printing)

The National Association of Insurance Commissioners is an association of state insurance regulatory officials. This association helps the various Insurance Departments to coordinate insurance laws for the benefit of all consumers. You are urged to use this Guide in making a life insurance purchase.

#### Buying Life Insurance

When you buy life insurance, you want a policy which fits your needs without costing too much. Your first step is to decide how much you need, how much you can afford to pay and the kind of policy you want. Then, find out what various companies charge for that kind of policy. You can find important differences in the cost of life insurance by using the life insurance cost indexes which are described in this guide. A good life insurance agent or company will be able and willing to help you with each of these shopping steps.

If you are going to make a good choice when you buy life insurance, you need to understand which kinds are available. If one kind does not seem to fit your needs, ask about the other kinds which are described in this guide. If you feel that you need more information than is given here, you may want to check with a life insurance agent or company or books on life insurance in your public library.

This guide does not endorse any company or policy.

#### Choosing the Amount

One way to decide how much life insurance you need is to figure how much cash and income your dependents would need if you were to die. You should think of life insurance as a source of cash needed for expenses of final illnesses, paying taxes, mortgages or other debts. It can also provide income for your family's living expenses, educational costs and other future expenses. Your new policy should come as close as you can afford to making up the difference between (1) what your dependents would have if you were to die now, and (2) what they would actually need.

#### Choosing the Right Kind

All life insurance policies agree to pay an amount of money if you die. But all policies are not the same. There are three basic kinds of life insurance.

1. Term insurance
2. Whole life insurance
3. Endowment insurance

Remember, no matter how fancy the policy title or sales presentation might appear, all life insurance policies contain one or more of the three basic kinds. If you are confused about a policy that sounds complicated, ask the agent or company if it combines more than one kind of life insurance. The following is a brief description of the three basic kinds:



### Term insurance

Term insurance is death protection of a "term" of one or more years. Death benefits will be paid only if you die within that term of years. Term insurance generally provides the largest immediate death protection for your premium dollar.

Some term insurance policies are "renewable" for one or more additional terms even if your health has changed. Each time you renew the policy for a new term, premiums will be higher. You should check the premiums at older ages and the length of time the policy can be continued.

Some term insurance policies are also "convertible". This means that before the end of the conversion period, you may trade the term policy for a whole life or endowment insurance policy even if you are not in good health. Premiums for the new policy will be higher than you have been paying for the term insurance.

### Whole Life Insurance

Whole life insurance gives death protection for as long as you live. The most common type is called "straight life" or "ordinary life" insurance, for which you pay the same premiums for as long as you live. These premiums can be several times higher than you would pay initially for the same amount of term insurance. But they are smaller than the premiums you would eventually pay if you were to keep renewing a term insurance policy until your later years.

Some whole life policies let you pay premiums for a shorter period such as 20 years, or until age 65. Premiums for these policies are higher than for ordinary life insurance since the premium payments are squeezed into a shorter period.

Although you pay higher premiums, to begin with, for whole life insurance than for term insurance, whole life insurance policies develop "cash values" which you may have if you stop paying premiums. You can generally either take the cash, or use it to buy some continuing insurance protection. Technically speaking, these values are called "nonforfeiture benefits". This refers to benefits you do not lose (or "forfeit") when you stop paying premiums. The amount of these benefits depends on the kind of policy you have, its size, and how long you have owned it.

A policy with cash values may also be used as collateral for a loan. If you borrow from the life insurance company, the rate of interest is shown in your policy. Any money which you owe on a policy loan would be deducted from the benefits if you were to die, or from the cash value if you were to stop paying premiums.

#### Endowment Insurance

An endowment insurance policy pays a sum or income to you - the policyholder - if you live to a certain age. If you were to die before then, the death benefit would be paid to your beneficiary. Premiums and cash values for endowment insurance are higher than the same amount of whole life insurance. Thus endowment insurance gives you the least amount of death protection for you premium dollar.

### Finding a Low Cost Policy

After you have decided which kind of life insurance fits your needs, look for a good buy. Your chances of finding a good buy are better if you use two types of index numbers that have been developed to aid in shopping for life insurance. One is called the "Surrender Cost Index" and the other is the "Net Payment Cost Index". It will be worth your time to try to understand how these indexes are used, but in any event, use them only for comparing the relative costs of similar policies. LOOK FOR POLICIES WITH LOW COST INDEX NUMBERS.

#### What is Cost?

"Cost" is difference between what you pay and what you get back. If you pay a premium for life insurance and get nothing back, your cost for the death protection is the premium. If you pay a premium and get something back later on, such as a cash value, your cost is smaller than the premium.

The cost of some policies can also be reduced by dividends; these are called "participating" policies. Companies may tell you what their current dividends are, but the size of future dividends is unknown today and cannot be guaranteed. Dividends actually paid are set each year by the company.

Some policies do not pay dividends. These are call "guaranteed cost" or "non participating" policies. Every feature of a guaranteed cost policy is fixed so that you know in advance what your future cost will be.

The premiums and cash values of a participating policy are guaranteed, but the dividends are not. Premiums for participating policies are typically higher than for guaranteed cost policies, but the cost to you may be higher or lower, depending on the dividends actually paid.

#### What Are Cost Indexes?

In order to compare the cost of policies, you need to look at:

1. Premiums
2. Cash Values
3. Dividends

Cost indexes use one or more of these factors to give you a convenient way to compare relative costs of similar policies. When you compare costs, an adjustment must be made to take into account that money is paid and received at different times. It is not enough to just add up the premiums you will pay and subtract the cash values and dividends you expect to get back. These indexes take care of arithmetic for you. Instead of having to add, subtract, multiply and divide many numbers yourself, you just compare the index numbers which you can get from life insurance agents and companies:

1. Life Insurance Surrender Cost Index. This index is useful if you consider the level of the cash values to be of primary importance to you. It helps you compare costs if at some future point in time, such as 10 or 20 years, you were to surrender the policy and take its cash value.

Life Insurance Net Payment Cost Index. This Index is useful if your main concern is the benefits that are to be paid at your death and if the level of cash values is of secondary importance to you. It helps you compare costs at some future point in time, such as 10 or 20 years, if you continue paying premiums on your policy and do not take its cash value.

There is another number called the Equivalent Level Annual Dividend. It shows the part dividends play in determining the cost index of a participating policy. Adding a policy's Equivalent Level Annual Dividend to its cost index allows you to compare total costs of similar policies before deducting dividends. However, if you make any cost comparisons of a participating policy with a non participating policy, remember that the total cost of the participating policy will be reduced by dividends, but the cost of the non participating policy will not change.

#### How Do I Use Cost Indexes?

The most important thing to remember when using cost indexes is that a policy with a small index number is generally a better buy than a comparable policy with a larger index number. The following rules are also important:

- (1) Cost comparisons should only be made between similar plans of life insurance. Similar plans are those which provide essentially the same basic benefits and require premium payments for approximately the same period of time. The closer policies are to being identical, the more reliable the cost comparison will be.
- (2) Compare index numbers only for the kind of policy, for your age and for the amount you intend to buy. Since no one company offers the lowest cost for all types of insurance at all ages and for all amounts of insurance, it is important that you get the indexes for the actual policy, age and amount which you intend to buy. Just because a "Shopper's Guide" tells you that one company's policy is a good buy for a particular age and amount, you should not assume that all of that company's policies are equally good buys.

- (3) Small differences in index numbers could be offset by other policy features, or differences in the quality of service you may expect from the company or its agent. Therefore, when you find small differences in cost indexes, your choice should be based on something other than cost.
- (4) In any event, you will need other information on which to base your purchase decision. Be sure you can afford the premiums, and that you understand its cash values, dividends and death benefits. You should also make a judgement on how well the life insurance company or agent will provide service in the future, to you as a policy holder.
- (5) These life insurance cost indexes apply to new policies and should not be used to determine whether you should drop a policy you have already owned for awhile, in favor of a new one. If such a replacement is suggested, you should ask for information from the company which issued the old policy before you take action.

#### Important Things To Remember - A Summary

The first decision you must make when buying a life insurance policy is choosing a policy whose benefits and premiums must closely meet your needs and ability to pay. Next, find a policy which is also a relatively good buy. If you compare Surrender Cost Indexes and Net Payment Cost Indexes of similar competing policies, your chances of finding a relatively good buy will be better than if you do not shop. REMEMBER, LOOK FOR POLICIES WITH LOWER COST INDEX NUMBERS. A good life insurance agent can help you to choose the amount of life insurance and kind of policy you want and will give you cost indexes so that you made cost comparisons of similar policies.

Dont't buy life insurance unless you intend to stick with it. A policy which is a good buy when held for 20 years can be very costly if you quit during the early years of the policy. If you surrender such a policy during the first few years, you may get little or nothing back and much of your premium may have been used for company expenses.

Read your new policy carefully, and ask the agent or company for an explanation of anything you do not understand. Whatever you decide now it is important to review your life insurance program every few years to keep up with changes in your income and responsibilities.





APPENDIX C

LEGAL OPINIONS ISSUED BY  
THE ARIZONA LEGISLATIVE COUNCIL



# ARIZONA LEGISLATIVE COUNCIL

## MEMO

March 27, 1979

TO: Douglas Norton, Auditor General  
FROM: Arizona Legislative Council  
RE: Request for Research and Statutory Interpretation (O-79-16)

Your request, dated March 16, 1979, concerns the authority of the director of the department of insurance to approve or disapprove rate filings for property and marine insurers and vehicle, casualty and surety insurers.

### QUESTIONS PRESENTED:

1. Under what circumstances, if any, may the director disapprove filings without holding a hearing?
2. May the department legally issue "preliminary disapprovals"?
3. Does the director, or his employees, have the authority to negotiate acceptable filings with insurers or is the director limited to approving or disapproving filings as they are submitted?
4. If the director may negotiate acceptable filings, must the negotiations be conducted in writing to comply with the provisions regarding written notices of disapproval?
5. Do the provisions requiring hearings imply a public "right to know" that may be unaddressed by private negotiations between the department and the insurers?

The director of the department of insurance is authorized to approve and disapprove rate filings under Title 20, chapter 2, article 4, Arizona Revised Statutes.

In general, an insurance commissioner or other state officer vested by statute with the power to fix or approve insurance rates cannot exceed his statutory authority in respect to that power, but he may lawfully exercise reasonable discretion. In addition, there must be compliance with statutes prescribing the method of procedure by which rates are to be fixed (44 Corpus Juris Secundum Insurance Section 60).

The statutory procedures applicable to property and marine rate filings differ from the statutory procedures applicable to vehicle, casualty and surety rate filings so the discussion of your questions relating to disapproval of filings will be treated separately.

## Property and Marine Rate Filings

Arizona Revised Statutes section 20-344 requires insurers to file property and marine rates with the director of the department of insurance.

There are certain circumstances under which the director may disapprove property and marine rate filings without holding a hearing. The director may disapprove filings when no statute requires a hearing. For example, Arizona Revised Statutes section 20-350, subsection B authorizes the director to disapprove a specific inland marine rate filing on a risk specially rated by a rating organization by sending a written notice of disapproval within thirty days after the filing with the director. It is important to note that this type of filing becomes effective when it is filed with the director. Also, the director must act within thirty days after the filing becomes effective.

Arizona Revised Statutes section 20-351 establishes the procedure for disapproving an inland marine rate filing on a specially rated risk after the thirty-day review period is over. If, more than thirty days after the filing becomes effective, the director determines that a specific inland marine rate filing does not comply with applicable statutes, the director is required to give notice, hold a hearing and, after the hearing, issue an order specifying in what respects the filing fails to comply with the statutory requirements and stating the date after which the filing will no longer be effective.

However, before the director disapproves other types of property and marine rate filings a hearing is required. This conclusion is reached by a close reading of Arizona Revised Statutes sections 20-350 and 20-351.

For property and marine rate filings, other than specific inland marine rate filings on specially rated risks, the rate filing must be on file for a waiting period of fifteen days before it becomes effective (Arizona Revised Statutes section 20-345, subsection B).

The director of the department of insurance is required to review any property and marine rate filing as soon as reasonably possible to determine whether it complies with statutory requirements (Arizona Revised Statutes section 20-345, subsection A). By giving written notice within the fifteen-day period, the director may extend the waiting period an additional fifteen days in order to consider the filing.

Arizona Revised Statutes section 20-350, subsection A prescribes the procedure the director is required to follow if he determines, after his review within the fifteen-day period and any extension of time if requested, that the rate filing should be disapproved. If the director finds that the property and marine rate filing does not meet statutory requirements:

. . . within the waiting period or any extension thereof . . .  
he shall send to the insurer or rating organization . . .

written notice of disapproval of such filing, specifying therein in what respects he finds that such filing fails to meet such requirements and stating that such filing shall not become effective. Before he disapproves any such filing, the director shall give notice and hold a hearing as provided in section 20-351.

In interpreting the language of Arizona Revised Statutes section 20-350, subsection A, two canons of statutory interpretation should be kept in mind. Each word, clause and sentence of a statute should be given effect. No statute should be construed so that one part will be inoperative or superfluous, void or insignificant or so that one section will destroy another unless the provision is the result of obvious mistake or error. Sutherland, Statutory Construction, section 46.06 (4th Ed.).

The required notice of disapproval apparently constitutes a notice that the director intends to disapprove a filing. The notice of disapproval cannot be construed to be the disapproval since notice and a hearing are also required prior to the disapproval. Further, the notice and hearing must follow the procedures prescribed in Arizona Revised Statutes section 20-351. Arizona Revised Statutes section 20-351 prescribes the procedure for disapproving a rate filing after it has become effective. This statutory section requires at least ten days' written notice prior to the hearing and requires the director to issue an order, after the hearing, stating the findings and decision of the director.

Since the director has only fifteen days to review a filing before it becomes effective the notice of disapproval does act as a "preliminary disapproval". However, the notice of disapproval must be followed by a hearing and order that the filing will not become effective.

If at any time after a property and marine rate filing becomes effective the director determines that it does not comply with applicable statutes, the director is required to follow the disapproval procedures specified in Arizona Revised Statutes section 20-351. This statutory procedure is also required for disapproval of a specific inland marine rate filing on a risk specially rated by a rating organization which has been effective for more than thirty days.

Reading Arizona Revised Statutes sections 20-350 and 20-351 together, it is apparent that the "notice of disapproval" does effectively stop property and marine rate filings and specific inland marine rate filings effective less than thirty days from becoming effective. However, for property and marine rate filings not yet effective, the notice of disapproval must be followed by a hearing and order.

#### Vehicle, Casualty and Surety Rate Filings

Arizona Revised Statutes section 20-357, subsection A requires insurers to file with the director of the department of insurance vehicle,

casualty and surety rating systems they propose to use. Except for certain special filings, each rate filing is required to be on file for a waiting period of fifteen days before it becomes effective (Arizona Revised Statutes section 20-357, subsection C).

The only procedure available to the director for disapproving a vehicle, casualty and surety rate required to be filed or a rating system not required to be filed is specified in Arizona Revised Statutes section 20-358, subsection A:

. . . he shall, after a hearing held upon not less than ten days written notice, . . . issue an order specifying in what respects he finds that the filing or rating system fails to meet the requirements . . . and stating when . . . the filing or unfiled rating system shall be deemed no longer effective.

For vehicle, casualty and surety rate filings the director is not required by statute to review a filing "as soon as reasonably possible" after it is filed despite the fact that a fifteen-day waiting period is provided before it becomes effective. For purposes of disapproving a filing, no distinction is made between filings which have not become effective and filings which are in effect.

If a person or organization other than the insurer or rating organization which filed the rate filing feels aggrieved by a filing or any unfiled rating system the person or organization is authorized to apply in writing to the director for a hearing. After the hearing the director may, by order, declare that a filing or rating system will no longer be effective after a specified date (Arizona Revised Statutes section 20-358, subsection B).

No statutory authority exists which specifically provides for a "preliminary disapproval" nor is it possible to construe existing statutory language to provide for a "preliminary disapproval" of vehicle, casualty and surety rate filings.

The remaining questions in this request concerned "negotiations" conducted by the department and insurers. No statutory authority exists for "negotiating" acceptable rate filings. However, it is apparent that the director has the authority to communicate directly with insurers.

As noted earlier in this opinion the director of the department of insurance has only the powers prescribed by statute for purposes of approving or fixing insurance rates.

Arizona Revised Statutes sections 20-350, 20-351 and 20-358 provide for the disapproval of certain rate filings, but the sections do not authorize the director to fix rates if the director does not approve of the rates filed.

It is unclear in this situation what is involved in "negotiating". It is clear that the director is not authorized to impose or fix rates in the cited situations. However, the director may require an insurer to furnish the

information upon which the insurer supports its filings (Arizona Revised Statutes sections 20-344, subsection A and 20-357, subsection A).

Also, the intent of this statutory regulation is clearly stated in Arizona Revised Statutes section 20-341:

. . . to promote the public welfare by regulating insurance rates to the end that they shall not be excessive, inadequate or unfairly discriminatory, and to authorize and regulate cooperative action among insurers in rate making and in other matters . . . . Nothing . . . is intended to prohibit or discourage reasonable competition, or to prohibit or encourage . . . uniformity in insurance rates, rating systems, rating plans or practices. This article shall be liberally interpreted to carry into effect the provisions of this section.

Without focusing more specifically on the details of "negotiating", communication between the director and insurers is certainly contemplated by this legislation and encouraged to the extent necessary and advisable to accomplish the purposes stated. However, the director is required to act in accordance with his statutory authority. To the extent that "negotiating" results in the director setting rates either directly or indirectly, "negotiating" is not permitted.

The fourth question asks whether the private "negotiations" would have to be conducted in writing to comply with the statutory provisions regarding a written notice of disapproval. As noted earlier in this opinion the written notice of disapproval prescribed in Arizona Revised Statutes section 20-350 is part of the required statutory procedures the director must comply with. In that sense it is not a "negotiation".

The last question relates to private "negotiations" between the director or the department and insurers as violating the public's "right to know".

An argument may be made that the public's "right to know" does not extend to rate filings and supporting information submitted by insurers relating to property and marine rates and vehicle, casualty and surety rates.

Arizona Revised Statutes section 20-344, subsection A provides that "(a) filing and any supporting information shall be open to public inspection after the filing becomes effective".

One may argue that, using the "expressio unius" rule of statutory construction, the meaning of this language is so clear that it would not permit expansion. Sutherland, Statutory Construction, section 47.25 (4th Ed.). In other words, a filing and supporting information would not be open to the public before the filing becomes effective.

This section has not been interpreted by any court. It is possible that, in light of the recent trend toward open government and court decisions and attorney general opinions concerning public documents, absent any compelling reason, the public, upon request, could inspect filings and supporting information prior to the time the filings become effective. However, the period of time before filings become effective is brief. For filings which are disapproved it has already been determined that a public hearing is required prior to disapproval. In that case the public would certainly be informed of the filing and any supporting information. There does not appear to be a compelling reason for permitting the filing and supporting information to remain confidential. This language, arguably, reflects a period of time when the presumption was not that all documents relating to public business should be available to the public, but, rather, it was necessary to ensure, through statutory language, that certain information would be available to the public. However, before this question is answered in a more definitive manner, additional information is necessary. Also, please review the memo dated March 14, 1979 furnished by this office concerning an earlier request numbered (O-79-4) for additional discussion of what constitutes a public record.

The response to this question leads to one further observation. Title 20, chapter 2, article 4, Arizona Revised Statutes, relating to rates and rating organizations was initially enacted in part by Laws 1947, chapter 126 and expanded and codified by Laws 1954, chapter 64. The language of the statutory sections quoted in this memo have not changed substantially since the codification of 1954. If the statutory procedures seem unworkable or undesirable in current times it would seem appropriate to revise the statutes to make necessary and desirable changes.

### CONCLUSIONS

1. The director of the department of insurance may disapprove only a specific inland marine rate filing on a specially rated risk within thirty days after it is filed with the director without holding a hearing by sending a written notice of disapproval (Arizona Revised Statutes section 20-350, subsection B).

2. The director, by sending a written notice of disapproval for property and marine rate filings under Arizona Revised Statutes section 20-350, subsection A, does in effect issue a "preliminary disapproval" because the notice of disapproval is not effective unless the director holds a hearing and issues an order after the hearing.

3. The director and his employees do not have the authority to "negotiate" rate filings with insurers if the direct or indirect effect of the "negotiating" is that the director fixes rate filings.

4. The written notice of disapproval required for disapproval of certain rate filings is not a "negotiation".

5. The question of the public's "right to know" about "negotiations" between the department and insurers is not subject to proper review without additional facts and specific instances.



# ARIZONA LEGISLATIVE COUNCIL

## MEMO

March 29, 1979

TO: Douglas R. Norton, Auditor General  
FROM: Arizona Legislative Council  
RE: Request for Research and Statutory Interpretation (O-79-15)

This is in response to a request made on March 15, 1979 in which the following fact situations were presented:

1. An employee of the Department of Insurance is receiving a renewal commission each year from a former employer (an insurance company). These commissions result from continuing life insurance policies sold by this employee while an agent for the insurer.

2. An employee of the Department of Insurance will receive a monthly annuity beginning some point in the future. This paid-up deferred annuity was earned as a retirement benefit while employed by an insurance company. The terms and amount of that benefit were determined while working for the insurer.

3. An employee of the Department of Insurance has a 6% mortgage loan with an insurer who is regulated by the Department. The mortgage loan was obtained prior to employment with the Department of Insurance.

### QUESTION PRESENTED:

Do the above fact situations constitute a conflict of interest as defined in A.R.S. section 20-149?

### ANSWER:

For fact situations 1 and 3, a conflict of interest exists. For fact situation 2, a conflict of interest does not exist.

A.R.S. section 20-149 reads in relevant part as follows:

A. The director, or any deputy, examiner, assistant or employee of the director shall not be financially interested, directly or indirectly, in any insurer, agency or insurance transaction except as a policyholder or claimant under a policy . . .

B. The director or any deputy or employee of the director shall not be given nor receive any fee, compensation, loan, gift or other thing of value in addition to the compensation provided by law for any service rendered or to be rendered as such director, deputy or employee or in connection therewith.

C. This section shall not be deemed to prohibit employment by the director of retired or pensioned personnel of insurers or insurance organizations.

The leading case in Arizona which interprets Arizona Revised Statutes section 20-149 is Bushnell v. Superior Court of Maricopa County, 102 Ariz. 309, 428 P.2d 987 (1967). This case held that the statutory declaration that the state director of insurance "shall not be financially interested, directly or indirectly in any insurer" prohibited the director from obtaining a mortgage loan from an insurer engaged in business in this state and regulated by the director.

The court in Bushnell stated that the purpose of the statute was intended to prohibit the director from placing himself in any position where he would have a possible conflict of interest. Under the rule of statutory construction that the expression of one thing excludes another, the court concluded that the director may be financially interested in an insurer, agency or insurance transaction only as a policyholder or claimant under a policy.

Fact situation 3 is similar to the facts in Bushnell except the party in question is an employee of the department rather than the director and the mortgage loan was obtained prior to employment by the Department. However, A.R.S. section 20-149, subsection A applies to the director, or any deputy, examiner, assistant or employee of the director. The language is clear on its face. The director or an employee of the director may not have a financial interest in any insurer except for the enumerated exceptions. Moreover, an exception not made cannot be read into the language. Sutherland, Statutory Construction, section 47.11 (4th Ed.). No exception is provided in subsection A to allow an employee to obtain or hold a loan from an insurer. Under Bushnell, this means that an employee of the director cannot receive or hold a mortgage loan from an insurer that is regulated by the department.

Bushnell refers to a Florida statute, F.S.A. section 624.305, that is identical to A.R.S. section 20-149 except for an exception which states that:

(3) This section shall not be deemed to prohibit an insurer from making, in regular course of business, a loan to the insurance commissioner and treasurer, or any deputy, assistant, examiner, actuary, counsel, or other employee of the department if such loan is adequately secured by a mortgage upon real estate or other collateral . . .; or from acquiring or holding, in regular course of business, such a loan or investment originally made by others.

As reasoned by the Court in Bushnell:

The fact that the Florida legislature tacked on an additional provision expressly approving of a loan transaction between the director of insurance and an insurer strongly indicates that the legislature thought such a specification was necessary in order that such a transaction should not be prohibited under the general language of the other sections of the statute. 102 Ariz. at 312, 428 P.2d at 990.

Hence the absence of this particular provision in the Arizona statute is some indication that the Arizona Legislature intended that a loan between an employee of the director and an insurer was prohibited by the terms of section 20-149.

A conflict of interest statute is designed to remove or limit the possibility of personal influence which might bear upon an official's decision. Yetmen v. Naumann, 16 Ariz. App. 314, 492 P.2d 1252 (1972). In addition, the proper test in all conflict of interest situations is not whether an actual conflict exists but whether the possibility of a conflict exists. Ins. Dept. of the Commonwealth of Pennsylvania v. Johnson, 432 Pa. 543, 248 A.2d 308 (1968).

Applying these principles to A.R.S. section 20-149, it appears that the holding and rationale of Bushnell apply to fact situation 1. It is true that Bushnell stated that in order to violate subsection B the director would have to be acting in his official capacity as director while rendering a service and, in return for such service rendered or to be rendered, receive something of value. In fact situation 1, it is clear that the employee in question is not rendering a service to an insurer in his capacity as an employee of the director. Hence, no violation of subsection B is involved. However, Bushnell stated that the provisions of subsection A are to be read broadly and that:

. . . [T]he legislature must have intended that where there is a private or personal transaction, other than those covered by the above enumerated exceptions, between the Director of Insurance and an insurance company involving money in some manner, such is a transaction forbidden by the terms of the statute. 102 Ariz. at 311, 428 P.2d at 989.

Therefore, since the language of A.R.S. section 20-149, subsection A applies also to employees of the director, any money transaction between an employee of the director and an insurer is prohibited. This would apparently apply to renewal commission fees received from an insurer for past services rendered.

Finally, A.R.S. section 20-149, subsection C states that "This section shall not . . . prohibit employment by the director of retired or pensioned personnel of insurers . . .". This exception applies directly to fact situation 2.

Webster's Third New International Dictionary defines a pension as "a fixed sum paid regularly to a person". An annuity is defined in Arizona Revised Statutes section 20-254.01 as encompassing "all agreements to make periodic payments, . . . , where the making or continuance of all or of some of a series of such payments, or the amount of any such payment, is dependent upon the continuance of human life". Thus, it appears that the term "pension" is broad enough to include a deferred annuity. Therefore, an employee of the Department of Insurance would not be in a position where a conflict of interest exists if he receives a deferred annuity earned as a retirement benefit while previously employed by an insurer.

#### CONCLUSION:

A conflict of interest would exist if an employee of the Department of Insurance received a renewal commission from a former employer who was also an insurer or received or held a mortgage loan from an insurer. No conflict of interest would exist if an employee of the director received a paid-up deferred annuity earned as a retirement benefit while employed by an insurer.

cc: Gerald A. Silva  
Performance Audit Manager



