



*Report
to
The LEGISLATIVE FINANCE COMMITTEE*



Public Regulation Commission
Review of Management Practices of the Insurance Division
October 3, 2005

Report # 05-03

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October 3, 2005

Ben R. Lujan, Chairman
New Mexico Public Regulation Commission
1120 Paseo De Peralta
Santa Fe, New Mexico 87504

Dear Chairman Lujan:

On behalf of the Legislative Finance Committee (Committee), I am pleased to transmit this review of management practices of the New Mexico Public Regulation Commission Insurance Division.

The review team interviewed key personnel, examined documents, reviewed laws and regulations, and analyzed data provided by the New Mexico Public Regulation Commission. The report will be presented to the Committee on October 3, 2005. An exit conference was held on September 14, 2005 to discuss the contents of the report. Commissioner briefings were also conducted.

I believe that this report addresses issues the Committee asked us to review and hope the New Mexico Public Regulation Commission will benefit from our efforts. The review team appreciated the cooperation and assistance provided by your staff.

Sincerely,

A handwritten signature in cursive script that reads "David Abbey".

David Abbey
Director

DA\JL:lg

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The objective of this review was to assess the effectiveness of insurance regulation by the Public Regulation Commission (PRC) regarding insurance company examinations, consumer complaints, and rate regulation. Structural, procedural, and database weaknesses that may affect consumers were noted.

The PRC has six divisions. The Insurance Division has a relatively high level of autonomy. This structure appears to precipitate some of the findings of this report.

Insurance Company Examinations. Current practices may give the appearance of favoritism. There are no written internal policies and procedures governing the selection and responsibilities of contract examiners. Market conduct examination selection is undocumented. Statutory guidelines are not followed.

- A contractor performed 87 percent of recent examinations and has been paid over \$10 million since 2003.
- A contractor examined companies that a family member represented as an insurance agent.
- Contractor compensation exceeds statutory guidelines (see Table 1 below).

Table 1. Examiner-In-Charge Hourly Compensation

Contract Rates	Statutory Base Rate
\$116-155	\$43

Source: LFC analysis

Law prescribes that compensation be based on, but no limited to, rates suggested by the National Association of Insurance Commissioners. Contract examiner compensation is paid by insurance companies, and passed on to policyholders.

The review indicated that contract examiner work was of acceptable quality.

Insurance Complaints. The PRC’s Consumer Relations Division and Insurance Division have overlapping statutory complaint-handling responsibilities. In some cases, complaint information in the database is inaccurate or incomplete, and database functionality limits automated analysis and consumer access. Complaint analysis is neither thorough nor comprehensive. Consumer access is limited. Handling of some

Contract Examiner Selection Process Lacks Controls

One Contractor Performed 87 Percent Of Recent Examinations

Contractor Compensation Is High

Complaint-Handling Responsibilities Overlap

complaints gave the appearance of favoritism to PRC employees. Statutory requirements are not followed.

- The relationship between the two divisions handling complaints is strained. Research shows that most states handle insurance complaints within one division.
- Two out of 32 complaints reviewed were inquiries, not complaints.
- Manual complaint analysis performed is arduous, time consuming and subject to human error.
- New Mexico is one of 10 states that do not make aggregated complaint data available to the public. Consumers lack a key tool for making informed insurance choices.
- On-line complaint filing is not available, and on-line forms and information are in English only.
- PRC complaint correspondence sent to an insurance company stated that the complainant was a PRC employee's daughter.
- Complaint reports required by statute were not completed.

The review indicated that timeliness of complaint resolution was acceptable, though challenging to assess.

Insurance Rate Regulation. New Mexico's approach to rate regulation limits its effectiveness. Virtually all rate filings are reviewed, which may not be cost effective. Rates are approved by the Insurance Division, not the PRC. Rate filing and analysis procedures have weaknesses.

- Processing and analyzing all rate filings regardless of the magnitude of consumer impact is ineffective because of the excessive time and resources required.
- Only one percent (15) of over 1,400 property and casualty rate filings was disapproved.

The intention of requiring prior regulatory approval is to maintain a reasonable insurance marketplace. However, requiring approval of all requested rate increases, whether for one percent or 25 percent, is not cost effective. Some states use a "flex-rate" approach, which combines elements of prior approval and open competition. Under flex-rate, rates in competitive insurance markets can change up to a certain limit without prior approval. Regulatory control is thereby provided where competition is insufficient.

Complaint Database and Analysis Have Weaknesses

Consumers Have Limited Complaint Access And Information

Approach To Rate Regulation Limits Effectiveness And Efficiency

Flex-Rate Approach Targets Regulation Efforts

***Premium Tax Collection
Procedures Need
Improvement***

***Select Contract Examiners
By Competitive Bidding
And Increase Pool Of
Contractors***

***Improve Complaint
Handling, Analysis, And
Consumer Access***

***Consider Pursuing
Changes To Law***

Revenue Collection. Insurance premium tax collection activities are impeded by database, efficiency, and staffing limitations. In FY05 \$144 million in premium taxes were collected by the PRC.

- The database has unreliable company premium data.
- Payment processing and past-due collection procedures include manual elements.
- Processing and collections staff has an excessive workload and has a backlog of refunds dating back to 2004 to process.

Other Issues For Possible Further Review. The review team was informed of procedural weaknesses regarding licensing. This topic was not reviewed. Of the Insurance Division's 84 full-time equivalent employees, 16 work in licensing.

Recommendations. Adopt internal written policies for contract examiners that require:

- Selection based on competitive request-for-proposal;
- Maintenance of an adequate pool of examiners and rotation of examinations;
- Prohibitions against conflicts of interest; and
- Compensation within legal requirements.

Document selection reasons for market conduct examinations performed.

Perform consistent and seamless complaint-handling. Maintain an accurate and functional complaint database. Perform periodic, thorough complaint analysis. Improve consumer access to complaint information.

Efficiently process insurance premium taxes and actively pursue past-due taxes.

Work with the LFC budget analyst to determine the most effective and efficient organization structure.

Consider amending laws to:

- Clarify complaint-handling responsibilities of the Consumer Relations Division and the Insurance Division; and
- Adopt flex-rate regulation in competitive markets.

REVIEW INFORMATION

Background. Article XI of the New Mexico constitution created the Public Regulation Commission (PRC) to charter and regulate business corporations, including insurance companies.

Article 8 NMSA 1978 is cited as the PRC Act. Six PRC organizational units were created by the act, including the Insurance Division and the Consumer Relations Division. Per the act, the Insurance Division superintendent has the statutory powers and duties prescribed in Chapter 59A NMSA 1978, also cited as the insurance code. Per the act, the Consumer Relations Division was created to perform duties that include the following.

- Receive and investigate nondocketed consumer complaints;
- Ensure fair and timely resolution of complaints; and
- Advise the PRC on consumer issues.

Section 59A-2-1-B NMSA 1978 states that all powers relating to state supervision of insurance, insurance rates and rate practices, together with collection of insurance licenses, taxes or fees, and all records pertaining to such supervision are under control of the PRC through the Insurance Division.

Section 59A-4-5 NMSA 1978 states that the superintendent may examine insurance companies that transact business in New Mexico as often as deemed advisable. The superintendent is to consider National Association of Insurance Commissioners examination handbooks in conducting examinations. Section 59A-4-5 NMSA 1978 states that for scheduling examinations, the superintendent shall consider factors that include policyholder complaints.

Section 59A-4-6 NMSA 1978 states that the superintendent may employ, and fix reasonable compensation for, contract specialists to represent the superintendent in examinations. Section 59A-4-14 NMSA 1978 states that the company examined shall pay all reasonable costs and expenses of the examination, based on the suggested compensation amounts of the National Association of Insurance Commissioners.

Section 59A-17-5 NMSA 1978 authorizes the superintendent to administer all provisions of Article 17 NMSA 1978, also cited as the insurance rate regulation law. This law's purposes include:

- Regulating insurance rates so that they are not excessive, inadequate, or unfairly discriminatory; and
- Encouraging reasonable price competition among insurers, and providing regulatory controls when competition fails.

Section 59A-17-9 NMSA 1978 states that rate filings shall not become effective until approved by the superintendent.

There is no significant federal regulation of insurance. There are national insurance organizations. The National Association of Insurance Commissioners is made up of the heads of the insurance departments of all states, the District of Columbia, and four United States territories. This organization conducts accreditation activities and proposes laws and rules. The National Conference of Insurance Legislators is an organization of state legislators. This organization provides education and information for legislators to make informed insurance regulation decisions, and develops model laws.

Laws 2004, Chapter 5 provided for appropriations from an insurance operations fund to fund the Insurance Division. For FY06, the division eliminated its general fund request, and the \$6.2 million budget includes \$3.5

million in funding from the insurance operations fund (included in “Fund Balance” in Table 2, below). The division collects taxes and licensing fees, with monies deposited into an insurance department suspense fund. Under previous law, collections would have been transferred to the general fund. In FY05, the Insurance Division reported collecting \$165.1 million, including \$144.4 million in insurance premium taxes. The FY05 suspense fund distribution to the general fund was \$95.9 million.

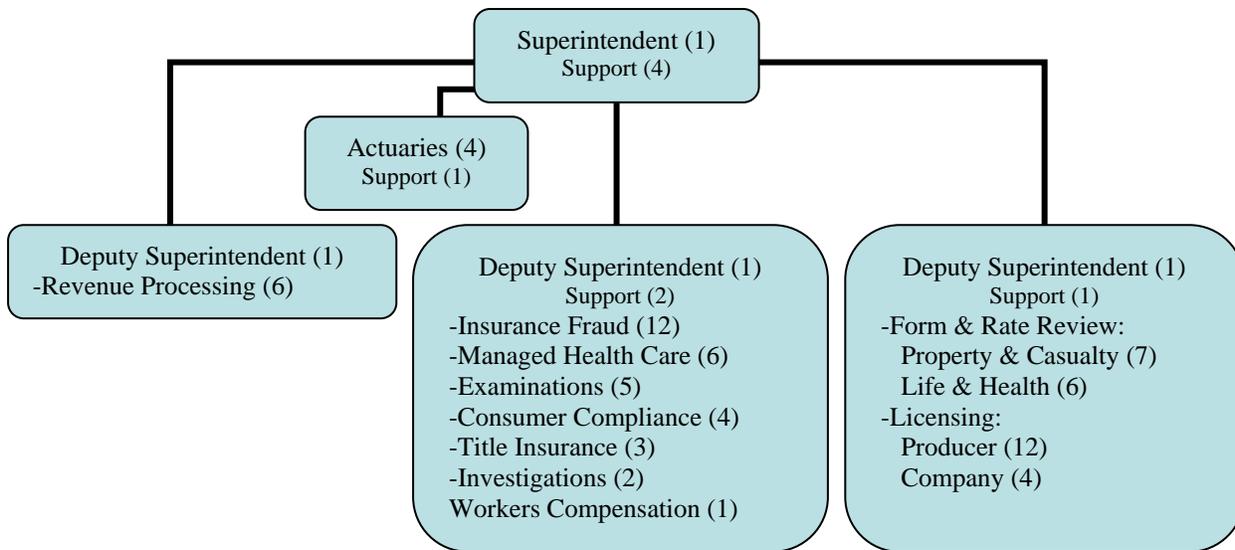
**Table 2. Insurance Policy Program FY06 Operating Budget
(In thousands)**

Sources:		Uses:	
Other Transfers	\$1,057.5	Personal Services/Employee Benefits	\$4,887.8
Fund Balance	\$5,130.7	Contractual Services	\$215.5
		Other	\$974.9
		Other Financing Uses	\$110.0
Total	\$6,188.2	Total	\$6,188.2

Source: Public Regulation Commission FY06 Operating Budget

Laws 2005, Chapter 33 authorized 84 full-time equivalent employees for the insurance policy program. Staff distribution is depicted in Figure 1, below. This review encompassed activities performed by approximately 60 percent of the staff.

**Figure 1. Insurance Policy Program Organization Chart
(Full-Time Equivalents)**



Source: Public Regulation Commission, Insurance Division

Objectives. Specific objectives of this review were to determine if:

- Consumer insurance complaint procedures were satisfactory;
- Insurance company examination procedures were satisfactory; and
- Other aspects of consumer protection, including rate regulation, were adequate.

Scope. The scope of this review included:

- Complaints received April 1, 2004 to March 31, 2005;
- Insurance company examinations adopted January 1, 2004 to June 30, 2005; and
- Insurance company rates filed April 1, 2004 to March 31, 2005.

Procedures. Procedures included, but were not limited to:

- Review of laws and regulations;
- Review of external data including information from the National Association of Insurance Commissioners, the National Conference of Insurance Legislators, and other states;
- Analysis of reports, policies, and procedures provided by the PRC;
- Testing of a sample of complaints, insurance company examinations, and rate filings for the period April 1, 2004 to March 31, 2005;
- Discussions with PRC staff and contractors; and
- Discussions with Legislative Finance Committee staff.

Authority for Review. The Legislative Finance Committee (Committee) has the statutory authority under Section 2-5-3 NMSA 1978 to examine laws governing the finances and operations of departments, agencies and institutions of New Mexico and all of its political subdivisions, the effects of laws on the proper functioning of these governmental units and the policies and costs. The Committee is also authorized to make recommendations for change to the Legislature. In furtherance of its statutory responsibility, the Committee may conduct inquiries into specific transactions affecting the operating policies and cost of governmental units and their compliance with state law.

Review Team. The review team members were:

G. Christine Chavez, Deputy Director for Performance Audit
Dhvani Doshi, Performance Auditor
Jonathan Lee, Performance Auditor
Charles Sallee, Performance Auditor

Exit Conference. The contents of this report were discussed with Commissioner Chairman Ben R. Lujan, Chief of Staff Daniel W. Mayfield, Insurance Division Superintendent Eric Serna, and other Public Regulation Commission staff on September 14, 2005.

Report Distribution. This report is intended for the information of the Office of the Governor, the Public Regulation Commission, the Office of the State Auditor, Department of Finance and Administration and the Legislative Finance Committee. This restriction is not intended to limit distribution of this report which is a matter of public record.

G. Christine Chavez

G. Christine Chavez
Deputy Director Performance Audit
Legislative Finance Committee

FINDINGS and RECOMMENDATIONS

INSURANCE COMPANY EXAMINATIONS

Contract Examiner Compensation Is High. Contract examiner compensation is higher than what appears to be directed by statute. Section 59A-4-14 NMSA 1978 states that contract examiner compensation should be based on, but not limited to, National Association of Insurance Commissioners (NAIC) suggested compensation. This organization provides suggested compensation for different examination team members, and using examiner-in-charge compensation allows for the following comparison.

Table 3. Hourly Compensation Rates For Examiner-In-Charge

PRC Contract Rates	NAIC suggested base rate
\$116-155	\$43

Source: LFC analysis

The Insurance Division does not have documentation of analysis performed to determine contract examiner compensation rates. The examiner-in-charge was compensated \$150 per hour for the examinations reviewed. This person had the credentials of Certified Financial Examiner, Certified Insurance Examiner, and Certified Public Accountant. While the Insurance Division is to be commended for using such a qualified examiner, these qualifications exceed what is recommended by the National Association of Insurance Commissioners. The organization does not recommend that the examiner-in-charge be a Certified Public Accountant.

Keeping examination costs down in New Mexico may benefit consumers via lower cost of insurance. The Executive Director of the Insurance Marketplace Standards Association stated in testimony to the United States Senate in September 2004 that high market conduct exam costs are ultimately passed on to consumers.

Recommendation. Set contract examiner compensation based on National Association of Insurance Commissioners suggested rates, as per statute. Consider pursuing statutory changes to revise contract examiner compensation language if a documented compensation analysis indicates the need.

Contract Examiner Procedures Are Not Covered By Internal Policies And Lack Adequate Controls.

The PRC has no formal internal written policies that cover the use of contract examiners, and in this environment one contract examiner firm has performed 87 percent of all recent examinations.

All PRC insurance company examinations are conducted by contract examiners. Analysis of examinations that were adopted, or were in the process of being adopted, from January 1, 2003 to June 30, 2005 shows that one contract examiner firm performed 87 percent of the examinations. Such a consolidation of examination work with one contractor may not provide the depth and diversity needed to properly conduct examinations. For this same two and one-half year time period, this firm received \$10.0 million in fees and travel reimbursement for examination work performed for the Insurance Division.

Areas in need of internal policy coverage include the following.

Procurement. The PRC does not use a competitive request-for-proposal process for contract examiners, and the criteria considered and decision analysis activities are not documented. Because contract examiner compensation is paid by the examined insurance companies, the state procurement code does not apply. Among

regional states, Arizona and Colorado use the request-for-proposal process, and Utah has plans to institute the process. The Insurance Division's agreements with contract examiners have no termination date.

Conflicts of Interest. The contracts between the Insurance Division and contractors refer to prohibitions against conflicts of interest, but there are no requirements that examiners disclose companies for which they may have a conflict.

The principal of the predominantly-used contract examiner firm is related to an insurance agent, which raises questions about the contractor's independence and objectivity in conducting examinations.

- The insurance agent currently has appointments with many insurance companies that the contract examiner's firm has examined for the Insurance Division.
- Based on analysis of the agent's current appointments, the contract examiner's firm performed examinations, and the principal was the examiner-in-charge, for three companies that his relative was concurrently representing as an agent.

The principal of the predominantly-used contract examiner firm has an additional relationship with the Insurance Division that could give the appearance that the contractor receives favorable treatment. He is on the division's "Solvency Team" that sets insurance company priorities for calling examinations. All other team members are division employees.

The Insurance Regulatory Examiners Society awards the Certified Insurance Examiner designation. The society's code of professional conduct and ethics states that members should maintain objectivity and be free of conflicts in fact and in appearance, and that independence precludes relationships that may appear to impair a member's objectivity. The Society of Financial Examiners awards the Certified Financial Examiner designation. The society's code of ethical conduct states that members shall not give reasonable basis for the impression that they are affected by kinship.

Examination Staffing. Contract examiners provide a team of examiners to perform examinations. Team member qualifications and competency are important in the examiners' role as agents of the PRC. However, the contracts between the Insurance Division and contract examiners do not specify minimum qualifications or credentials of the contractor's staff.

Documented Review of Market Conduct Examination Work Performed. Review of three examinations' workpapers indicated that for one, a market conduct examination, there was minimal documented evidence that the proposed examination procedures, or other workpapers, were reviewed or approved by either the contract examiner-in-charge or an employee of the Insurance Division. Additionally, the workpapers were relatively unorganized. The market conduct examination report was adopted by the Insurance Division in January 2005. The workpapers for the other two examinations reviewed were very organized, and contained extensive and clear evidence of review and approval. It is noted that the division has successfully maintained accreditation by the National Association of Insurance Commissioners, which encompasses financial examinations and procedures. Market conduct examinations are not considered in accreditation.

Compensation. For one examination reviewed, an examiner was paid at the rate of \$150 per hour, but according to the division's contract with the contract examiner, examiners' pay was limited to \$115 per hour. Con-

tractor invoices are approved by the Insurance Division prior to being submitted by the contractor to the insurance company for payment. Therefore the invoices were approved for the incorrect rate, and the company was over-charged.

Recommendation.

- Develop and adopt written internal policies regarding contract examiners that include appropriate internal controls.
- Institute the competitive request-for-proposal process to select contract examiners, and seek to maintain a qualified pool of examiners.
- Submit reports of request-for-proposal activities, and selected contract examiners, to the PRC commissioners for review.
- Institute a requirement that examinations be rotated among contractors.
- Require a conflict of interest disclosure during the request for proposal process, and before each examination, that includes disclosure of insurance companies for which conflicts may exist, including family member conflicts.
- In contracts between the Insurance Division and contract examiners, or in the request-for proposal documents, specify minimum qualifications and credentials for examination team members.
- Ensure that examination workpapers are maintained in an orderly fashion and clearly evidence review by the examiner-in-charge and the Insurance Division.
- Ensure that contract examiners are charging the agreed-upon pay rates to insurance companies.
- Include a termination date in contracts with contract examiners.
- Maintain an appropriate arm's length relationship with contract examiners.

Market Conduct Examinee Selection Is Weakened By Unreliable Complaint Data. Complaint data is central to effective analysis in selecting companies for market conduct examination, but the Insurance Division's complaint data and database present limitations to effective and efficient analysis. Section 59A-4-5 NMSA 1978 states that for scheduling examinations, the superintendent may consider policyholder complaints, and that market conduct guidance provided by the National Association of Insurance Commissioners may be followed. This guidance stresses performing complaint analysis. However, as noted elsewhere in this report, there are deficiencies in the complaint database and analysis.

The division does review national complaint data provided by the National Association of Insurance Commissioners during examination planning, but this data has limited usefulness because:

- The data is not specific to New Mexico;
- As noted elsewhere in this report, the New Mexico complaint data is not reliable; and
- The data for many other states is also unreliable because approximately 50 percent of all complaints are accounted for in the national database.

For the three examinations reviewed, there was no documentation in the workpapers describing the selection process for each. It is noted that the division has a selection matrix document for calling market conduct examinations, however the matrix document was not completed for the market conduct examinations reviewed.

Recommendation. Correct complaint database and analysis deficiencies, and make complaint analysis central to market conduct analysis activities. Document the selection decision analysis for each examination performed.

Examination Database Is Not Accurate. The Insurance Division's examination database has incomplete data for 20 of the 35 examinations adopted since 2000. Information such as docket numbers and examination dates were missing. The database does not specify if the examinations are financial or market conduct. An accurate examination listing is important for internal tracking purposes to monitor examination progress, and for review by PRC commissioners and other interested parties.

Recommendation. Maintain an accurate database of all examinations that includes all information deemed important for tracking.

Examination Workpapers Ownership Is Not Clear. There are no agreements regarding the ownership and control of workpapers produced by contract examiners. Some workpapers for completed examinations are under the control of a contract examiner. These workpapers are therefore not readily available for use by PRC staff, or for review by future examination teams examining the same company.

Recommendation. Formalize examination workpaper ownership, control, and security policies. Include such language in contracts with contract examiners.

CONSUMER COMPLAINTS

PRC Structure Includes Overlapping Complaint-Handling Responsibilities. Within the PRC, both the Consumer Relations Division and the Insurance Division have complaint handling roles. This structure is consistent with law. Section 8-8-8-A-1 NMSA 1978 gives the Consumer Relations Division authority to receive, investigate, and assist consumers in fair and timely resolution of non-docketed consumer complaints. However, the Insurance Division also has statutory authority that requires complaint handling. Section 8-8-9-A NMSA 1978 states that the superintendent of the Insurance Division shall have all powers and duties prescribed to him in the insurance code, which is Chapter 59A NMSA 1978. Section 59A-4-4 NMSA 1978 gives the superintendent the power of examination, and section 59A-4-5 NMSA 1978 states that complaints may be considered in scheduling examinations. Section 59A-57-5-A NMSA 1978 states that complaints regarding managed health care are to be handled by the superintendent.

Coordination between the two divisions is important towards efficient and effective complaint handling. Many complaints received by the Consumer Relations Division are forwarded to the Insurance Division, including those that may indicate violations of the insurance code or that require advanced insurance expertise and knowledge. The Insurance Division is also responsible for maintaining the insurance complaint database and transmitting complaint data to the National Association of Insurance Commissioners for inclusion in a national complaint database. However, the divisions are housed in different buildings, operate under their own procedures, and have had disagreements about how complaints should be handled. During this review the tension between the two divisions was evident. The problem has progressed to the point that a memorandum of understanding between the divisions is being considered.

In looking at structures in all states, there are 22 including New Mexico where the state insurance department is within a larger regulatory department (Insurance Division within the PRC, in New Mexico). Regionally, these include Colorado and Nevada.

However, in analyzing how some regional states handle complaints, it is uncommon for two units to handle complaints like in New Mexico.

Table 4. Units That Handle Insurance Complaints In Regional States

New Mexico	Arizona	Colorado	Nevada	Utah
Consumer Relations Division, and Insurance Division	Insurance Department	Insurance Department	Insurance Department	Insurance Department

Source: LFC analysis

The Consumer Relations Division also has statutory responsibilities to advise the PRC on consumer issues, and to assist in developing and implementing consumer programs.

Appeals of Insurance Division decisions are heard by the Superintendent, whereas appeals pertaining to other PRC divisions are heard by the commissioners.

Recommendation. Provide efficient, consistent, and effective insurance complaint resolution for consumers. Develop and adopt unified complaint-handling policies, eliminating division-specific procedures and the need for inter-divisional memorandums of understanding. Include PRC contact information on complaint literature and inform consumers of the roles of the divisions. Research structure options, and consider revising statutes to clarify or revise division responsibilities. Work with LFC analyst on restructure. Consider placing complaint-handling responsibilities with the Insurance Division, accompanied by a consumer-advocacy role performed by the Consumer Relations Division. Consumer advocacy could include:

- Surveying complainants for satisfaction levels regarding complaint handling;
- Assessing the accuracy of information in the complaint database; and
- Assisting in providing greater consumer access to the complaint process and complaint information.

Complaint Procedures Are Inconsistent And Inadequately Documented. The PRC does not have written procedures for complaint handling, and complaints are not handled in a consistent manner. Different groups within the PRC that handle complaints have individual procedures. For instance, the Consumer Relations Division has some documented procedures, although the division director acknowledged that the procedures need revision. The Insurance Division does not have written procedures, except for some data entry procedures used by the Managed Health Care Bureau. The following inconsistencies were noted during review of a sample of complaints received by the PRC from April 1, 2004 to March 31, 2005, and indicate the need for a means to ensure consistency in complaint handling.

- A standardized complaint form is not always completed by the complainant. Complaints are accepted in various forms including letter, fax, and over the telephone. As a result, a standard set of data is not collected for all complaints.

- Form letters, such as the letters to insurance companies requesting a formal response to a filed complaint, are not standardized.
- Communications received from complainants and insurance companies are not always date-stamped by the PRC.
- Documentation in files evidencing supervisory review is minimal.

Additionally, the PRC has a performance measure from the 2005 General Appropriation Act for the dollar amount of credits and refunds consumers receive as a result of PRC complaint resolution efforts. In five of the 32 complaint files reviewed, the figures could not be reconciled back to supporting documentation. There is no written methodology for calculating this figure, and different complaint-handling groups appear to calculate this figure in different ways.

Recommendation. Develop and adopt written complaint handling procedures to ensure compliance with law in providing timely and fair complaint resolution. Develop procedures to ensure consistent handling of all complaints. Require:

- That PRC complaint forms be completed for all complaints;
- The use of standard form letters;
- Date-stamping of all correspondence received;
- Evidence of supervisory review in all complaint files; and
- A standard methodology to calculate dollars credited and refunded to consumers.

Consumer Access And Awareness Are Limited. There are several areas where consumer access to, and awareness of, the complaint function could be improved.

- Consumers can download a complaint form from the PRC's internet site, but they cannot directly enter their complaint on-line. New Mexico is one of 15 states that do not accept complaints on-line.
- Complaint information on the PRC internet site, and complaint forms, are available only in English. Review of regional states shows that Arizona, Colorado, and Texas provide complaint information and forms in English and Spanish.
- The Managed Health Care Bureau regularly makes presentations and educates consumers on health insurance and complaint filing. There is minimal other concerted effort by the PRC to educate consumers on other types of insurance, such as home and auto insurance.

By improving consumer access to the complaint function, complaints might reach the PRC that would otherwise never be filed. A more complete representation of consumer complaints gives the PRC a better understanding of consumer problems in the marketplace, and a better tool for making regulatory decisions.

Recommendation. Provide on-line complaint submission and company complaint data. Provide complaint information and forms to both English and Spanish speaking consumers. Conduct consumer outreach efforts that inform a wide array of consumers of their access to the complaint process. Consider enhancing the existing Managed Health Care Bureau outreach program to include information on other types of insurance.

Complaints Related To PRC Employees Received Exceptional Treatment. The PRC does not have guidelines for handling complaints related to PRC employees. During review of complaints, some employee complaints had indications of special handling as compared to other complaints reviewed.

In one instance, a complaint was filed by the daughter of an employee. The file included a letter from the PRC to the insurance company that stated that the complainant was the PRC employee's daughter, and mentioned the employee by name once and by title five times. The file also included notation that the employee asked that the complaint be handled in a normal manner. Using the name of a specific PRC employee in written communication with an insurance company was not noted in other complaint files.

Another complaint filed by a PRC employee pertained to homeowner's insurance, but the complaint was handled by a PRC employee whose job was to handle managed health care complaints. Likewise, two other complaints that were referred to the PRC by an employee were similarly not related to health care, but were handled by the same PRC employee on the managed health care complaint staff. No other complaints reviewed were directed to particular staff members in other groups.

The public is best served by a complaint handling process where all complaints are handled consistently and with equal diligence.

Recommendation. Develop and adopt a policy regarding the handling of complaints related to PRC employees that addresses equal treatment for all complaints. Designate employee complaints in the database, and provide a report of employee complaints on a regular basis to the PRC commissioners.

Statutorily-Required Complaint Reporting Was Not Performed. Section A-8-8-8-B NMSA 1978 requires the Consumer Relations Division to include a report of consumer complaints and their status in the PRC's annual report. Section 59A-57-5 NMSA 1978 requires an annual report on managed health care, to include consumer complaints information. The PRC's fiscal year 2004 annual report did not include either report.

Recommendation. Perform all statutorily-required reporting.

The Complaint Database Is Inadequate. The quality of information in the PRC's complaints database is not sufficient to support useful analysis. Insurance complaints are maintained in a single database. A sample of 32 files for the 1,371 complaints received from April 1, 2004 to March 31, 2005 was reviewed. The following issues related to complaint procedures, and the complaints database, were noted. These factors weaken the quality of information in the database, and therefore its usefulness.

- None of the files included evidence of supervisory or peer review.
- In the database, two complaints were actually inquiries. The distinction is important because inquiries are not expressions of dissatisfaction, and overstate complaint figures when coded as complaints. Inquiries received from consumers are not always entered into the database.
- In the database, the opening or closing dates for three complaints were incorrect.

Other findings from this review include:

- Complaints pertaining to title insurance are not entered into the database; rather, they are maintained in a log by the Title Insurance Bureau of the Insurance Division. The log for 2004 shows that 16 complaints were handled by the bureau.
- State Farm writes homeowners insurance in New Mexico through State Farm Fire and Casualty Company, and auto insurance through State Farm Mutual Auto Company. Review shows that consumer complaints

pertain to both companies. However, all State Farm complaints are entered into the database under State Farm Fire and Casualty Company. Therefore, it erroneously appears in the database that there are no complaints regarding State Farm auto insurance.

- The database does not adequately allow for a notes feature, therefore many critical file notes are maintained on paper. The necessity to search for written file notes hinders the ability to efficiently handle complaints.
- In the database, the closing date for some complaints precedes the date the complaint was opened. For example, one complaint opened in 2004 is coded with a closing date in 1926 in the database.
- Database complaint information is not write protected, so any user can enter/change complaint data for any complaint in the database.
- The database does not allow for automated reports, so manual procedures are required by staff to analyze complaints. Manual procedures are time consuming, inefficient, and susceptible to human error.
- The database is not compatible with National Association of Insurance Commissioners' national complaint database, so New Mexico information cannot accurately be uploaded. Therefore, New Mexico complaint data in the national database is not reliable.

Complaint information is an important PRC tool for making decisions, including which insurance companies to target for market conduct examination. Complaint information is important for consumers to have at their disposal to make informed purchase decisions. Automation is a means to improve operational efficiency and effectiveness, and information systems should provide reliable information for decision-making.

Insurance Division staff stated they are aware of limitations in the current database, and that planning for a new database is underway. The LFC information technology staff is offering their assistance to the PRC towards these efforts.

Recommendation. Procedural recommendations are as follows.

- Ensure all insurance complaints are entered into the database.
- Adopt a definition for a “complaint” as distinguished from an “inquiry,” and ensure that the database accurately reflects this distinction.
- Adopt a review procedure to check for the accuracy of data entered into the database.
- Require supervisory review for all complaints.

Database program recommendations are as follows.

- Improve database security with rights features, by type of user and by user groups, to protect data.
- Institute controls that prohibit illogical date information from being accepted.
- Ensure adequate report generation capabilities and functionality.
- Ensure compatibility with the National Association of Insurance Commissioners' national database.
- Provide a notes function for each complaint that will be sufficient to replace the current practice of maintaining handwritten notes.
- Solicit input from current database users regarding desirable features of the future database.
- Consider accepting assistance offered by the LFC information technology staff.

Complaint Analysis Is Weak. Complaint analysis is not performed on a regular, systematic basis. The Consumer Relations Division does some regular analysis, but only on a select subset of property and casualty companies. The Managed Health Care Bureau of the Insurance Division does some irregular analysis on managed health care companies. In both cases, the analysis is manual-intensive, arduous, and subject to human error. The inability of the complaints database to produce useful reports is a significant barrier to adequate analysis.

Complaint analysis is a key tool for monitoring the marketplace and making decisions, such as which companies to target for examination, and for advising the PRC as required by statute.

Recommendation. Institute procedures to ensure that all complaints are subject to regular, systematic analysis that is communicated to the PRC, in compliance with law. Perform an adequate needs assessment, and automate the process.

Consumers Do Not Have Access To Insurance Complaint Data. The level of consumer protection provided by the PRC is weakened because data compiled on insurance company complaints is not readily available to consumers. Complaint information is an important factor for consumer consideration in choosing an insurer. New Mexico is one of only ten states that do not make aggregated complaint data available to the public.

Missouri is notable for providing their consumers access to information. The Missouri Department of Insurance provides complaint data through 2004 on its internet site that can be sorted by type of insurance, number of complaints, company market share, and by a complaint index. The index relates complaints to the amount of business written by companies, which normalizes the complaint data across all companies for ease of comparison.

Another complaint data source for consumers is a national database maintained by the National Association of Insurance Commissioners. The organization receives and compiles state complaint information and provides data for free on their internet site. However, the New Mexico data is not accurate due to database and transmission problems, as noted elsewhere in this report.

Recommendation. Provide New Mexico consumers with insurance complaint data that is timely, accurate, and readily available through the PRC internet site. Ensure that reliable complaint data is transmitted to the National Association of Insurance Commissioners for inclusion in their national complaint database.

RATE REGULATION

Rate Regulation Approach Is Restrictive. The Insurance Division's regulation of insurance rates may be more effective if performed in a different method. The division received approximately 1,420 property and casualty insurance rate filings for a recent one-year time period. Analysis shows that very few rates were not approved, as Table 5 below indicates. Staff time and resources may have been better spent reviewing only certain high priority rate filings.

Table 5. Status Of Rate Filings For 4/01/2004 Through 3/31/2005

Filing Status	Total	Percentage
Approved or Filed	1,359	95.7 %
Withdrawn	46	3.2 %
Disapproved	15	1.1 %
Total	1,420	100 %

Source: LFC Analysis

Methods used by states to regulate rates vary in regards to being restrictive. A very restrictive approach is “prior approval,” which requires that rate filings be reviewed and approved by the regulator before use in the marketplace. New Mexico uses this approach, with few exceptions. On the other extreme are very unrestrictive approaches, or competitive approaches, that allow insurance companies to take products to market upon filing, though the regulator may take action to block the product upon finding violations of regulatory requirements. Competitive approaches rely on the competitive marketplace to regulate pricing, and are therefore best suited for lines of insurance that have sufficient competition among insurers.

Section 59A-17-5 NMSA 1978 authorizes the superintendent to administer the insurance rate regulation law. The law’s purpose includes encouraging reasonable price competition among insurers, and providing regulatory controls when competition fails.

“Flex-rating” is an approach that combines elements of restrictive and competitive approaches. Rates in competitive markets can be changed, within a pre-approved range, without prior approval. In this way, the state insurance regulator pre-approves only the rate requests beyond a pre-determined threshold.

Louisiana, Rhode Island and South Carolina have adopted flex-rating laws for some property and casualty lines of insurance. The National Conference of Insurance Legislators has adopted flex-rating model laws. Table 6 compares the three states and the model law, and shows the mentioned states have adopted more restrictive flex-rating ranges than that promulgated by the National Conference of Insurance Legislators (NCOIL).

Table 6. Applicability Of Flex Rating Laws

	NCOIL	Louisiana	Rhode Island	South Carolina
Lines of Insurance	All Property and Casualty Personal	All Property and Casualty Personal	All Casualty, Fire and Marine, Non-Business	Fire, Allied, and Homeowners
Flex-Rate Range	+/-12%	+/-10%	+/-5%	+/-7%

Source: LFC Research

Compared to the prior approval approach, flex-rating reduces the number of rate filings that must be reviewed. The review team wanted to ascertain the number of rate filings reviews that could have been eliminated in recent time periods if New Mexico was operating under a flex-rating environment. However, due to weaknesses in the rate filings database this analysis was not performed.

Determining the level of marketplace competition is important for selecting the lines that are most appropriate for flex-rating. The National Conference of Insurance Legislators and the National Association of Insurance

Commissioners provide factors for considering whether reasonable competition exists. Factors include number of insurers providing coverage in the market, market concentration, and ease of entry into the market.

The PRC commissioners do not participate in rate setting activities performed by the Insurance Division.

Recommendation. Consider pursuing statutory change to allow flex-rating, initially on a test basis, in the most competitive insurance markets using guidance available for determining levels of competition. Quantify benefits in terms of savings in staff time and resources if the state were to adopt flex-rating laws.

Informal Rules Cap Rate Filings. The Insurance Division caps all property and casualty rate increases at 25 percent for any given policyholder by way of an unwritten rule. The rule is passed on by word-of-mouth to staff. Staff was not able to explain how or when this unwritten rule came into effect, or if insurance companies are aware of the cap. Review of 35 property and casualty rate filings indicated one instance where an insurance company applied for a rate increase greater than 25 percent, and Insurance Division staff notified the company that the request was not acceptable. Staff requested that the company submit a revised rate request capping the increase to 25 percent. The company complied with the staff's request.

Life and health rate increases are not subject to this informal cap. But as noted elsewhere in this report, increases of 25 percent or more require actuary staff approval, per the division's life and health procedure manual.

Recommendation. Consider if property and casualty rate increases should be capped and take necessary action to formalize such caps.

Unnecessary Rate Filing Review Work Was Performed. In a review of 35 property and casualty insurance filings, five were wet marine rate filings, which required no review. However, Insurance Division staff performed review and analysis of all five filings. Section 59A-17-2 NMSA 1978 exempts the regulation of wet marine insurance rates by the Insurance Division. Companies are required to file these rates and policy forms for informational purposes only, and not for approval. Time spent reviewing these filings could have been directed towards more critical activities.

Recommendation. Clarify policies and procedures to ensure that wet marine insurance filing documents are not unnecessarily reviewed.

Criteria For Requiring Advanced Review Of Rate Filings Need Improvement. Property and casualty rate change requests submitted to the Insurance Division receive either review by a rate analyst, or a more in-depth review by the actuary staff. The actuary staff reviews all filings from the three largest companies by premium volume, and all filings from rate service organizations. Beyond this process, review criteria are not risk-based. Rather, all other rate reviews are divided between the actuary staff and the analyst staff based on the first letter in the name of the insurance company.

Recommendation. Strengthen rate filing review criteria to ensure that actuary staff review is performed when appropriate. Include risk-based criteria such as the overall rate increase beyond a threshold, the degree of impact to policyholders, and whether the filing is an initial policy program rate filing.

Documentation Does Not Adequately Support Rate Review Activities Performed. The Insurance Division's procedure manual for life and health insurance requires that rate increase requests of 25 percent or more be reviewed and approved by the chief actuary. However, during a review of 20 rate filings, four were approved for 25 percent or more, but the approval files did not include evidence of chief actuary review or approval.

Two of the 20 life and health rate filings reviewed were approved based on analysis performed by computerized spreadsheets that contained built-in formulas, according to staff. The spreadsheet results were not printed or otherwise maintained for the approval files.

Review of 35 property and casualty rate filings indicated that seven cited reliance on rate service organization information to support the request. However, the approval files contained minimal evidence that the quoted information was verified for accuracy.

Recommendation. Ensure rate filing activities are in compliance with policy. Ensure that chief actuary review and approval are clearly documented when required. Maintain documentation on the disposition of every rate filing that indicates analysis performed, methodology used, assumptions made, and final disposition.

Rate Filing Database Has Weaknesses. Database weaknesses hamper efforts to perform accurate and meaningful database analysis. The Insurance Division utilizes the National Association of Insurance Commissioners' System for Electronic Rate and Form Filing database. The following weaknesses were noted.

Staff could not provide some requested database reports initially upon request. However, during this review staff contacted the National Association of Insurance Commissioners for assistance, and successfully generated the requested reports upon learning to use database queries and advanced search options.

Information on the magnitude of rate changes, over the prior rates, was not updated in the database for approximately the first eight months the database was used, starting in early 2004. Therefore, it is not possible to analyze data on rate increases approved for that time period.

Of the 1,420 property and casualty rates filed from April 1, 2004 to March 31, 2005, in six cases the database contains an incorrect approved rate. In these cases, the filings were originally submitted for rates that exceeded the division's informal 25 percent cap, but were re-submitted, and approved, at a rate below the 25 percent maximum. The problem is procedural. The administrative staff input information initially when filings were received, but the final approved rate was not updated in the database. Also among these 1,420 filings, typographical errors were noted in five filings. The database indicates these five filings were processed before they were received, which is not logical.

The database did not allow for the distinction between filings as rate filings, rule filings, form filings, or combinations of the three types. This filing-type distinction is important for performing analysis on each type of filing. After being told of this issue, the Insurance Division corrected the problem during this review with assistance from the National Association of Insurance Commissioners.

Recommendation. Ensure staff is adequately trained to utilize full database functionality. Replace all incorrect information for approved rates in the database with the correct information. Ensure accurate input of information into the database.

REVENUE PROCESSING

Premium Tax Collection Procedures Need Improvement. Premium tax collection activities performed by the Insurance Division have weaknesses regarding past-due monitoring, auditing, and the database.

The Insurance Division collects fees and taxes from insurance companies and agents. Division reports indicate that FY05 collections totaled \$165,095,186. The largest component was premium tax collections of approximately \$144 million. Section 59A-6-2 NMSA 1978 states that premium taxes of 3.003 percent of gross premiums are payable in quarterly estimated amounts, and a final return is due at year-end. Premium taxes are collected and processed by the Revenue Processing Bureau, Financial Audit Section.

The Insurance Division does not have an automated means of determining past due premium taxes. Premium tax information is contained in the division's Insurance Department Electronic Automated Licensing database. However, the database information for gross premiums is unreliable. Therefore, the premium tax due for each company cannot be determined via the database. When a tax payment is received, a bureau member performs analysis to determine if the payment is sufficient. If the payment is insufficient, the staff member sends a payment request letter to the company, and each staff member keeps track of the letters s/he has sent. There is no central system for tracking letters sent or taxes due. Furthermore, companies that do not submit payments to the Insurance Division are not analyzed for past due status.

In discussions with Financial Audit Section staff, it was apparent that their workload is excessive. There are five full-time equivalent employee positions. However, due to staff turnover, one position is currently vacant, and two employees were hired in 2005. The section supervisor indicated that training new employees detracts from productivity.

Insurance Division reports indicate that fees are collected from 1,436 insurance companies operating in the state. Using this figure, and other analysis performed, an approximation of the annual processing activity for the bureau was calculated, as shown in Table 7.

Table 7. Approximate Number Of Fee Processing Transactions Handled Annually By The Revenue Processing Bureau

Fee Type	Number of Companies	Submissions Required Per Year	Number Of Transactions Per Year
Premium Tax	1,436	5	7,180
Rate and Form Filings – Life and Health Insurers	Each filing requires a processing fee, LFC analysis indicates that from 4/1/05 to 3/31/05 556 filings were received		556
Rate and Form Filings – Property and Casualty Insurers	745	1	745
Annual Statement Filing Fees	1,436	1	1,436
Fraud Assessment	1,436	1	1,436
Total Transactions			11,353

Source: LFC Analysis

As shown above, fee processing for rate and form filings varies based on insurance type. Per Section 59A-6-1 NMSA 1978, for life and health insurance, fees are collected for every filing. For property and casualty insurance, an annual fee is collected, per Section 59A-6-1.2 NMSA 1978.

In addition to collecting fees, the Financial Audit Section also processes insurance company refund requests for premium tax overpayments. As stated above, the database does not accurately depict the gross premiums for companies. Therefore, staff must manually review company files to confirm gross premiums and the associated taxes due, and compare this to payments made in order to verify the refund due. Staff indicated that the backlog of refund requests totals approximately \$2.5 million and includes requests received dating back to 2004.

To remedy database weaknesses, staff is manually reviewing all company files for the last three years and entering premium and payment data into an Excel spreadsheet. These activities require staff time. The spreadsheet data will be exported at a later time into a database update, according to staff.

Recommendation. Improve efficiency in revenue collection procedures. Maintain a database that provides automated, accurate reports of company statutory compliance with premium tax payments required, and past due amounts. Prepare regular reports of past due premium taxes for the PRC. Consider pursuing a statutory change to accept an annual fee from companies for life and health filing activities.

DEPARTMENT RESPONSES

NEW MEXICO PUBLIC REGULATION COMMISSION

PUBLIC REGULATION COMMISSIONERS

Ben R. Lujan, Chairman

District 1 Jason Marks, Vice Chair
District 2 David W. King
District 3 Ben R. Lujan, Chair
District 4 Lynda M. Lovejoy
District 5 E. Shirley Baca



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September 22, 2005

TO: Legislative Finance Committee
RE: Findings and Recommendations of Insurance Division Audit

The New Mexico Public Regulation Commission (“Commission” or “PRC”) takes this opportunity to thank the Legislative Finance Committee (“LFC”) for its assistance and cooperation in the audit of the Insurance Division’s examination, consumer complaint, rate regulation and revenue processing operations. Acknowledging the work and analysis that have gone into the audit, the Commission agrees with much of the inquiry and notes that many of the findings and recommendations are consistent with its own initiatives to restructure the Insurance Division and improve performance. The Commission continues to be proactive in reviewing, evaluating and revising its internal processes in order to fulfill its mission to serve the public interest.

Attached to this letter are detailed responses to each of the September 15, 2005, audit’s findings and recommendations. Where appropriate, we have provided additional factual data, industry context and comparisons to practices in other states. In addition, we have elaborated on the assumptions we believe to be operative, and provided details as to the actions we have already undertaken to address the issues and areas identified in the audit. If statutory or regulatory change is necessary to accomplish the objectives of the audit, we have so indicated.

The PRC provides this response as the next stage in an ongoing dialogue with the legislature. We share the values of transparency, fairness, efficiency, accuracy and accountability. Despite budgetary constraints, we remain dedicated to implementing the directives of the legislature in our various subject areas, while coordinating and unifying our diverse divisions and coping with the logistical difficulties of location in separated buildings.

Finally, we are pleased to report that the accreditation team from the National Association of Insurance Commissioners recently completed an audit of the Insurance Division. The ensuing scores were high in all areas, and the team granted the Division a full five-year accreditation. We look forward to the next phase of this process.

I. INSURANCE COMPANY EXAMINATIONS

Re: the LFC's finding that, "Contract Examiner Compensation Is High."

The NAIC examiner rates cited by the LFC exclude per-diem. It is important to note that the examination company in question includes per-diem for examinations in New Mexico. As such, this is not an accurate comparison.

More importantly, the Insurance Division surveyed Chief Examiners of surrounding States to determine whether New Mexico's compensation rates for examiners-in-charge were high. The following table shows these results

Hourly Compensation Rates for Examiners-In-Charge				
New Mexico	Colorado	Arizona	Nevada	Utah
\$150 - \$155	\$150 - \$200	\$166.50	\$150 - \$155	\$210-350

Source: Insurance Division & Chief Examiners of Surrounding States.

As the table demonstrates, the rates paid to examination firms in surrounding states are comparable to rates paid in New Mexico.

Re: the LFC's finding that, "The Division of Insurance does not have documentation of analysis performed to determine contract examiner compensation rates."

The Division of Insurance documents their analysis of examiner compensation, as found in Attachment "A". This analysis was performed before the LFC audit. In fact, the analysis was not just reviewed within Insurance Division, but the Commissioners of the Public Regulation Commission reviewed, and were satisfied with, this analysis.

Re: the LFC's finding that IMSA Opposes Exam Costs.

The Public Regulation Commission concurs that IMSA opposes exam costs. IMSA (an association of Insurance Companies) has a vested interest in eliminating regulation through examinations, especially when examiners are more qualified than industry auditors.

The LFC audit does not state any specific data or other information to support its conclusion that compliance costs lead to higher premiums, when in fact, the opposite has occurred. Consumers have received refunds, of both premiums and proceeds from claims, based specifically on examination findings.

Only the pharmaceutical industry spends more in lobbying at the federal and state government level, which begs the question as to whether or not this money could be saved to lower premiums for insurance consumers.

Since our examiners are required to review the work of industry auditors, who are all Certified Public Accountants, it is necessary for our examiners to continue to be more qualified than industry auditors.

The PRC Will Institute a Formal RFP process.

Insurance Division examinations do not involve public money and are not subject to the New Mexico Procurement Code. The Insurance Code requires examined insurance companies pay the costs of ordered examina-

tions, and the Insurance Division has used a formal examiner selection and “best value” process that solicits a number of contract examination firms as illustrated by Attachment “A”.

Nevertheless, the Public Regulation Commission supports a formal RFP process and agrees that this would serve the public interest. The Commission discussed this matter at a Public Works Session in June and directed that the Insurance Division re-establish its list of qualified contract examiners using a formal RFP process sometime during FY2006. An RFP process will provide transparency into the Insurance Division’s process of selecting contract examiners of the “best value” by considering a respondent’s proposed rate, qualifications, proposal and residency.

Re: the LFC recommendation that the New Mexico Insurance Division follow NAIC rates, “as required by statute”.

The New Mexico Insurance Code permits the Insurance Division to adopt rates greater than the NAIC’s suggested compensation amounts, as in the surrounding states identified above. Section 59A-4-14(A) NMSA 1978, provides, in relevant part, that “...remuneration shall be based on *but not limited to* the suggested compensation amounts of a national association of insurance commissioners.” (Emphasis added)

Our legal interpretation of Section 59A-4-14(A) NMSA 1978, is that the Superintendent shall base examiner remuneration on NAIC suggested amounts, but not limited to the NAIC’s suggested amount. The NAIC suggested amounts are “guidelines” from which the Insurance Division may form a minimum basis for compensation rates. NAIC suggested amounts are not caps but a minimum suggested amount.

Nationally, only a small pool of qualified contract insurance examiners exists. State Insurance Departments compete for this small pool of qualified examiners and often, large States with larger insurance markets have a competitive advantage. The Insurance Division has hired contract examiners at the NAIC recommended rates in the past and our experience has been negative in that the available respondents offered poor qualifications and poor quality of service.

Insurance Division Should Utilize Examiners with Higher Qualifications

The Public Regulation Commission disagrees with the Audit Report’s findings regarding the Insurance Division’s utilization of contract examiners with qualifications exceeding the minimum qualifications suggested by NAIC guidelines.

Again, the NAIC’s guidelines are just that – guidelines and not legal requirements. The NAIC’s guidelines set a minimum level of qualifications for examiners, which is that examiners at least be “certified financial examiners”. The certified financial examiner or CFE designation is a far less stringent standard than an examiner who is also certified public accountant (CPA), a certified insurance examiner (CIE) or a juris doctor (JD).

For most examinations contracted for or by the Insurance Division, these additional professional certifications can and do result in a more comprehensive and higher-quality examination. The Insurance Division should be permitted to utilize examiners with higher qualifications than the minimum CFE whenever that will be of benefit. Utilization of examiners with higher and additional qualifications allows the Insurance Division to obtain the highest quality of services, as opposed to institutionalizing mediocrity. Moreover, contract examiners with CPA or CIE qualifications allows the Insurance Division to exam a company or companies within a holding company structure more efficiently and comprehensively, which lowers costs assuming insurance company’s timely cooperation.

The contract examiner-in-charge utilized in most New Mexico examinations is a certified public accountant (CPA), certified financial examiner (CFE), and certified insurance examiner (CIE). Less than 7% of all examiners working in the United States today maintain all three of these designations. As stated by the LFC report, this examiner exceeds the qualification levels as recommended by the NAIC and is a New Mexico native resident.

The LFC auditor states, “the NAIC does not recommend the EIC be a Certified Public Accountant”. However, the NAIC’s own accreditation team that visited New Mexico was made up entirely of CPA’s. This same NAIC accreditation team recently awarded the Insurance Division with high scores and granted a full five-year accreditation. The NAIC accreditation team gave the Insurance Division a very high score for their use of qualified staff.

Insurance Division has Voluminous Procedures for Market Conduct Exams and Contract Examiners

The Public Regulation Commission disagrees with the Audit Report’s finding that the Insurance Division has no written policies regarding contract examiners that deal with internal controls, document review, organization of work papers, rates, termination dates or conflict of interests. The Insurance Division provided the LFC auditor with the following documentation, evidencing written policies regarding contract examinations:

1. NAIC Financial Examination Handbook;
2. NAIC Market Conduct Examination Handbook (totaling over 700 pages);
3. Article 4 of the New Mexico Insurance Code;
4. Examiner Selection Matrix (*See* Attachment “A”);
5. Insurance Company Selection Scorecard (*See* Attachment “B”).

The Insurance Division’s Chief Examiner works closely with contract examiners to ensure that examinations progress appropriately, and that insurers provide examiners with requested information within a reasonable time frame consistent with Article 4 of the Insurance Code and the NAIC Handbooks. The Chief Examiner reviews all billings submitted by contract examiners before forwarding them to the insurers.

Public Regulation Commission will institute a formal RFP Process

The Public Regulation Commission’s Response contained above is incorporated by reference herein.

The mere fact that a contract examiner conducts a significant amount of examinations does not automatically necessitate a policy change. The Public Regulation Commission is aware of this issue but contends that the selected contract examiner is well qualified and fortunately resides in New Mexico (*See* Attachment “A”).

Automatic rotation would only work if there were a qualified pool of contract examiners with all the qualifications necessary to conduct a particular examination. The Insurance Division should have the discretion and flexibility to select a contract examiner based upon the needs of the particular examination. It should also be noted that consistent reliance upon a contract examiner with an established relationship with the Insurance Division represents a cost savings in terms of familiarity with the Insurance Division’s policies and procedures and New Mexico law.

The examination firm in question is the only New Mexico firm that performs examination services and maintains professional qualifications necessary to perform these types of services. Our contractor is one of the most qualified examiners in the United States and has provided examination services to the District of Colum-

bia, Georgia, Texas, Nevada, and Idaho at rates comparable to the rates charged in New Mexico or those of competing firms. The contractor is only one of a handful of people nationwide that possesses the CPA, CFE, and CIE credentials, and also serves on the Executive Committee as the Vice President and Governor of the National Society of Financial Examiners.

It is not uncommon for a contracting firm to perform the majority of examination services for a State Insurance Department. It provides for cost-savings, continuity and consistency in the process, which is important for continued NAIC accreditation. For example, Delaware exclusively uses one contracting firm to examine their domestic companies. This relationship dates back more than 2 decades.

NAIC Accreditation Approved Insurance Division's Work Paper Organization

The Insurance Division received a full 5-year accreditation from the NAIC recently, with no scheduled revisit and with high scores. The NAIC's national accreditation team reviewed several examinations to conclude that New Mexico's examinations, work papers, reports and management met or exceeded NAIC standards. As part of this process, the NAIC accreditation team reviewed the Insurance Division's written policies, internal controls, qualifications of examiners, approval processes and work papers. The scores from the accreditation team exceeded minimum required scores, just as our examiner's credentials exceeded the minimums required. We view our ability to exceed minimums as a strength. For these reasons, we do not understand how the NAIC's accreditation review of our processes arrived at a different outcome from the LFC audit with the same available information.

Insurance Division will Clarify Conflict of Interest Requirements

The Insurance Division will review and clarify its requirements for formal disclosure of a contract examiner's potential conflict of interest. At present, the Insurance Division's contracts with contract examiners contain a "conflict of interest clause" substantially similar to the "conflict of interest" clause required by the NAIC Examiner Handbooks. However, the Insurance Division will be asked to review and reference the Government Conduct Act in the manner required in standard professional services contracts. The Insurance Division will also be asked to develop a formal conflict of interest policy and procedure that emphasizes disclosure and documentation incorporated into a formal RFP process. We note that contract examiners are also subject to the ethical requirements of the Society of Financial Examiners, the Insurance Regulatory Examiner Society and the New Mexico Board of Public Accountancy.

Termination Clause is a Non-Issue

The contracts between the contract examiners and the Insurance Division contain a termination clause that allows either party to terminate the contract with at least 30 days written notice. This is a non-issue as examiners are assigned by examination, not for a specified duration.

The RFP Process Will Address Verification of Credentials

The implementation of a formal RFP process will address the Audit Report's finding and recommendation concerning verification of contract exam team credentials. We would note that during the period of the LFC examination, the Insurance Division exceeded the requirements for use of qualified competent staff as required by the NAIC accreditation, and provided written documentation about this process.

Work papers

The Public Regulation Commission acknowledges that the work papers in the examination in question were not well-indexed. The Insurance Division's Chief Examiner identified concerns with this examination while it was in progress, and as result subjected the examination to a heightened level of supervision, including requiring bi-weekly status reports, various drafts of the examination report were reviewed and rewritten by the Chief Examiner. While the Insurance Division believes the underlying quality of the examination was very good, we have not assigned further examinations to this particular vendor.

Insurance Division will Review Overcharge Allegation

The Insurance Division will review the allegation identified by the LFC auditor concerning the inaccurate rate for an exam team member. It is the Insurance Division's understanding that the examiner had increased responsibilities and was promoted to partner during the course of the particular examination, which would substantiate the higher hourly rate.

Insurer Selection for Examination is Well-Documented and Comprehensive. Complaint Data is only One Factor.

The Insurance Division described in detail and provided a detailed matrix to the LFC audit team concerning our process for calling market conduct examinations, for which written policies have been in effect for three years. The Division's "solvency team review process" looks at a number of factors, in addition to complaint data and beyond those suggested by NAIC market analysis to determine what examinations will be called in any given year. (See Attachment "B".) This information was also reviewed extensively by the Public Regulation Commission in a public hearing.

Expanding on the existing solvency review team process, the Insurance Division has made market analysis a key component of the Insurance Division's Restructuring Proposal. The Insurance Division has requested an appropriation for a Chief Market Analyst to coordinate our Consumer Protection and Enforcement program and develop an information system to track, monitor and report on complaints. Cleansing of complaint data would be part of information system development.

NAIC complaint data is only one of numerous factors in the Insurance Division's formal exam selection process. We are aware of the limitations and deficiencies of NAIC complaint data maintained by the NAIC.

Section 59A-4-5 NMSA 1978 states that in scheduling examinations, market conduct guidance provided by the NAIC may, not should, be followed. The NAIC does not provide guidance regarding the actual calling of examinations, but requires that the Insurance Division document its policies for what companies may receive an examination. This has been accomplished. (See Attachment "B".)

We Welcome "Best Value" RFP Process

The Public Regulation Commission's Response contained above is incorporated by reference herein.

RFP Process will Address Verification of Credentials

The Public Regulation Commission's Response contained above is incorporated by reference herein.

Insurance Division will Review its Conflict of Interest Requirements

The Public Regulation Commission's Response contained above is incorporated by reference herein. The Public Regulation Commission understands and appreciates the Audit Report's concern over the appearance of impropriety. We note that the contract examiner verbally disclosed to the Insurance Division that his relative is a licensed insurance broker not under the direct control of an insurance company. As an insurance broker, legal fiduciary duty is to the insured and not the insurance company. The Insurance Division's records show no complaints against the contract examiner's relative from a company, agent or consumer.

Additional Services Are Expected from Contract Examiners

The Insurance Division expects contract examiners to provide additional incidental services and finds no conflict of interest. All contract examination firms offer incidental services that the Insurance Division utilizes at its discretion. In fact, the contract examiner provided the LFC auditor with such services during the audit.

The provision of free incidental services does not reasonably indicate that a contract examination firm will gain favorable treatment from the Insurance Division. All contract examiners provide support services at no charge and examiners bill the insurance company examined, not the Insurance Division.

One service is solvency team participation. The Insurance Division requires all examiners-in-charge, whether contract or staff, to participate on the "Solvency Team" that sets insurance company exam selection priorities. The NAIC requires communication between the examiner-in-charge and the Insurance Division in settings such as "Solvency Team" meetings.

Insurance Division Supports Information Technology Development

The Insurance Division has made a consumer protection and enforcement information system and databases a key component of the Insurance Division Restructuring Proposal's *Consumer Protection and Enforcement Program*. Through the development of this information technology, the Insurance Division will be able to better analyze and substantiate enforcement activity. The ability to address this need has been hampered by the bifurcation of insurance complaint handling functions between the Consumer Relations Division and the Insurance Division.

Insurance Division will Review Ownership, Control & Security Requirements

Work paper ownership, control and security is governed by Insurance Code Section 59A-4-11(B), NMSA 1978, which states:

Except as expressly otherwise provided, pending, during or after examination of any insurer or other person, the superintendent shall not make public, or permit to be made public, any financial statement, report or finding affecting the status, standing or rights of the insurer or person until after the report of examination has been adopted by the superintendent, and all working papers, recorded information, documents and copies thereof produced by, obtained by or disclosed by the superintendent or any other person in the course of an examination shall remain confidential, are not subject to subpoena and may not be made public by the superintendent or any other person, except to the extent permitted by Sections 59A-4-7 and 59A-4-13 NMSA 1978. The superintendent may grant access to the national association of insurance commissioners on condition that it agree in writing prior to receiving the information to accord it the same confidential treatment as required by this section, unless the prior written consent of the insurer or the person to which it pertains has been obtained.

The Insurance Division and any examiner performing examinations on behalf of the Insurance Division is subject to this statutory provision as addressed by contracts between the Insurance Division and contract examiners, which include the following language:

J. Confidentiality.

Any information given to or developed by Contractor in the performance of this Agreement shall be kept confidential except as required by law.

Audit industry practice is that the contractor owns and maintains their work papers, while the principal owns the report. For instance, the Insurance Division would own the examination report. If any examination report findings are inaccurate, then the contract examiner would be liable and need to produce work papers to defend the its work.

The Insurance Division will review its contract examiner contracts to ensure that the ownership, control and security of work papers is clarified.

II. CONSUMER COMPLAINTS

Coordination of Consumer Relations Division & Insurance Division

The Public Regulation Commission has considered this issue and decided that it is in the public interest for informal insurance complaints to be handled by the Consumer Relations Division, with complaints that cannot be informally resolved forwarded to the Insurance Division.

As such, the Public Regulation Commission will continue to coordinate both Divisions to develop a uniform and seamless insurance complaint handling process supported by an information system that meets the needs of both Divisions. The Insurance Division has made this is a key component of its Restructuring Proposal and Consumer Protection and Enforcement Program. The PRC has directed that the divisions coordinate procedures for complaint handling, which can guide information system development, eliminate duplicative processes and improve data and reporting capability and accuracy.

Consumers want timely and helpful answers and resolutions of their life, auto, homeowners and other types of insurance issues. We want to provide them these services in the most accurate, informative, timely and consistent manner.

PRC Supports Uniform Complaint Handling Procedures

The Public Regulation Commission supports one set of complaint handling procedures supported by an information tracking system that provides seamless case development and transparency from initial receipt of the complaint to investigation to any formal enforcement action or closure.

PRC Supports One Complaint Form

A complaint form should be completed and filed in all cases unless there is extenuating circumstances where the consumer is uncomfortable with filling out a formal complaint form and provides a detailed letter with supporting documentation that provides all the necessary information. In such a situation, an initial contact staff member should, in all cases, enter the necessary information into the information system to provide a backstop in cases where a standard complaint form has not been completed and filed.

PRC Supports Date-Stamping

All correspondence from either a consumer, consumer representative or licensee should be date-stamped and logged into the information system. Similarly, clear definitions should be integrated into procedures and the information system to indicate when the file is received, initially investigated, resolved, recommended for formal investigation, etc... at each step of the process.

PRC is Concerned About “Dollars Saved” Performance Measure

The Public Regulation Commission wishes to review this performance measure for a number of reasons. Insurance complaint handling is not like a consumer’s complaint with a telephone or utility bill. Often times, consumers are complaining about the amount of a settlement of a claim related to an automobile or homeowner claim.

Another method for determining how a consumer is better served through intervention from the Insurance Division’s complaint process should be looked at during the next fiscal year and reported to the LFC accordingly.

PRC Supports Form Letters

The consumer complaint information system utilized by the Consumer Relations Division and Insurance Division has not been programmed for automatic form letter generation to assist staff. CRD Insurance complaint staff members have developed templates that contain standard boilerplate language for standard letters. The Public Regulation Commission supports a system to centralize the review by the PRC Legal Division, DOI and CRD of these documents, as well as the storage of these approved forms in a database.

PRC Supports Information System & Web-Based Technology

The Public Regulation Commission supports the development of an information system that integrates on-line transactions in terms of company and producer licensing support for speed-to-market and consumer complaint submission and processing.

Many New Mexico consumers are relying upon the Internet. The Public Regulation Commission is making web-based technology and e-commerce development a priority.

The Insurance Division has made a consumer complaint information system and database a key component of the Insurance Division Restructuring Proposal’s *Consumer Protection and Enforcement Program*. The Insurance Division has created a draft administrative investigations manual that will help outline the process for resolution and investigation of complaints and provides a roadmap for the development of an information system to better analyze complaint information by company and provide the complaint ratio information offered by other State Insurance Departments through websites and brochures. An initiative to publish complaint statistics on the Commission’s website is in process and should be live by the end of the year.

With a consumer complaint information system, the Public Regulation Commission can initiate outreach presentations throughout New Mexico to increase New Mexico citizens understanding of insurance as well as other products offered by the financial services industry. The Insurance Division and Consumer Relations Division have conducted outreach to New Mexico insurance consumers. Last year, the Insurance Division sent a team to KOB-TV Channel Four to receive telephone calls and answer questions during the newscast for all types of insurance. In addition, the Consumer Relations Division and Insurance Division have made staff available to staff a booth at the New Mexico Expo (State Fair) to answer consumer questions and receive complaints. Fi-

nally, the Insurance Division has issued news releases on various issues such as the association health plan bill being considered by the US Congress or discount health insurance scams to increase public awareness on pressing insurance issues

The Public Regulation Commission fully agrees that the more information should be provided in Spanish to increase access to the consumer services and information for New Mexico's Spanish-speaking population.

PRC Supports Uniform Complaint Handling Procedures

The Public Regulation Commission's response above is incorporated by reference herein.

PRC Will Perform Statutory Reporting.

The Public Regulation Commission will ensure that the Consumer Relations Division and the Insurance Division prepare the reports required by the Public Regulation Commission Act and Insurance Code.

PRC Supports Information System & Web-based Technology

The Public Regulation Commission's response above is incorporated by reference herein. In addition, the Public Regulation Commission supports complaint-handling procedures supported by an information system that provides seamless case development and transparency from initial receipt of the complaint, to investigation, to any formal enforcement action and to closure.

An information system would be developed to support this process and generate any necessary standard form letters to assist staff. Through the development of the information system, the distinction between an "inquiry" and "complaint" would be defined, coding would be standardized and all complaints received (including Title Insurance, Workers Compensation and Managed Health Care) would be incorporated into the system. The notes feature could be implemented, existing data can be migrated and corrected, and staff would be trained appropriately based on their authorization level.

Information System is Needed to Support Complaint Analysis

The Public Regulation Commission supports the development of an information system to support complaint handling and analysis. Lack of a sufficient information system hampers our efforts to report and analyze complaint data, which has been a constant issue raised by the Consumer Relations Division and Insurance Division. Standardization of procedures is a limited solution without adequate staff resources and an information system..

PRC Supports Consumer Access to Information

The Public Regulation Commission's response above is incorporated by reference herein.

III. RATE REGULATION

PRC and Insurance Division will Seriously Consider Flex-Rating

The Public Regulation Commission and Insurance Division will consider the LFC auditor's recommendation of adopting a "flexible rating" model. The Insurance Code may provide the Superintendent discretion in rate approval for lines of business where there is enough competition to regulate rates and "flex-rating" through a rulemaking. The Insurance Division would want a "flex-rating" model with a flexible automatic approval band baseline that could be adjusted by the Superintendent for different lines of property and casualty insurance. We would also want a consumer protection safeguard of automatic formal actuarial review for any rate

filing requesting an increase greater than 25% for any given policyholder, until we implement a risk-based or market analysis based approach.

Section 59A-17-5, NMSA 1978, only applies to specific lines of property and casualty insurance and does not apply to life and health insurance. If statutory changes are required to adopt a “flex-rating” or “file and use” model, then these proposals will need to be addressed at the appropriate Legislative Session, where the pro’s and con’s of such changes can be presented and considered by the Legislature through evidence and testimony by interested parties.

The Insurance Division requests additional staff with actuarial training. Currently the Insurance Division has one full-time property/casualty actuary and one full-time actuarial assistant for all property/casualty rate filings. Recruiting and hiring individuals with actuarial training to move to Santa Fe and work for the Insurance Division is a challenge. Another option would be to permit the Insurance Division to outsource by contract to an independent actuarial firm for assistance in property/casualty rate review and analysis.

Insurance Division will Implement Full Actuarial Review for Filings > 25%

The Insurance Division will consider formalizing property & casualty rate review of requested increases greater than 25% in a rulemaking as an interim solution until establish a risk-based or market analysis based structure for rate review that allows staff to develop market competition measurement tools.

Under New Mexico law, rate caps are impermissible, as the Insurance Code requires that only justifiable rates can be approved. As such, a rulemaking with a public hearing will be helpful in implementing a full actuarial review of all rate increase filings greater than 25%. It should be noted that any entity adversely affected by any action of the Superintendent has the right to request an Article 4 hearing.

Verification Review of Wet Marine Filings

Wet marine rate filings are not subject to prior approval, however some insurance company’s attempt to categorize rate filings as wet marine to avoid rate-filing review for prior approval. Our property & casualty insurance staff need to have the ability to perform a verification review rate filings categorized as “wet marine” to ensure that they are properly categorized and receive the appropriate level of rate review. Review steps that go beyond this verification will be eliminated.

Insurance Division Needs Staff with Actuarial Training

At present, the Insurance Division requires additional staff with actuarial training to comply with the LFC audit recommendation. Currently, the Insurance Division has one full-time life & health actuary, one full-time life & health staff member with actuarial training, one full-time property & casualty actuary and one full-time property & casualty actuarial assistant for all rate filings. Recruiting and hiring individuals with actuarial training to move to Santa Fe and work for the Insurance Division’s challenge, especially as SPO and PRC human resources have been unsuccessful in assisting the Insurance Division in establishing sufficient salary bands to recruit and hire an individual with actuarial training. Another option would be to permit the Insurance Division to outsource by contract to an independent actuarial firm for actuarial services.

The LFC recommendation would increase the number of rate filings to be reviewed by actuarial experienced staff, which would limit the Insurance Division to rely on these resources for other projects and services, such as company license application financial review or enforcement. Another impact might infringe upon our abil-

ity to meet existing performance measures for rate & form filing, company licensing and examinations units to hit targeted outcomes within prescribed timeframes.

Insurance Division Supports Reasonable Documentation

The Insurance Division agrees that procedures should include documentation that an actuary has reviewed rate increases over 25% for health insurance or property & casualty insurance products. Our two chief actuaries are completing the statutorily required review to the best of their ability; however, at present, the Insurance Division requires additional staff with actuarial training to comply with the LFC audit recommendation. Currently, the Insurance Division has one full-time life & health actuary, one full-time life & health staff member with actuarial training, one full-time property & casualty actuary and one full-time property & casualty actuarial assistant for all rate filings. Recruiting and hiring individuals with actuarial training to move to Santa Fe and work for the Insurance Division will be a challenge, especially as SPO and PRC human resources have been unsuccessful in assisting the Insurance Division in establishing sufficient salary bands to recruit and hire an individual with actuarial training. Another option would be to permit the Insurance Division to outsource by contract to an independent actuarial firm for actuarial services.

Insurance Division Will Continue to Improve Database

The Insurance Division agrees with the LFC's findings and recommendation. Our rate & form-filing units have worked on this process with the hiring of a qualified property & casualty actuarial assistant this year. We will continue to work on this project to address these concerns and maintain a unified database for life & health and property & casualty rate and form filing files.

IV. REVENUE PROCESSING

Insurance Division will Continue Performance and Data Base Improvement

The Insurance Division will consider the recommendations. The Financial Audit Section collects premium taxes and assessments, as well as reconciles 100% of the Insurance Division's funds. In 2004, the Insurance Division established a performance improvement team (PIT) for the Financial Audit Section. The PIT team assisted with the transition to a dedicated funding system, procedures to support performance measures, and a draft premium tax refund and credit rule for which we anticipate a rule-making hearing in the Winter of 2005.

The Financial Audit Section has also worked with contracted computer programmers of the IDEAL system to clean-up data and to enhance information system functionality to support the processing, auditing and reporting. Many aspects of the recommendation are in the process of being addressed by this work.

Finally, the Insurance Division and Chief of Staff are working diligently to fill existing vacancies in the Financial Audit Section with qualified candidates.

Examiner Selection Matrix

ANALYSIS OF EXAMINATION VENDORS

EXAMINATION VENDORS	Ranking		Ranking		Ranking		Ranking		Information regarding most recent examinations
	Range of Hourly Rates from Examiner to Partners	Rates with per-diem included.	Company Based in New Mexico	Experience with NM Div. of Ins.	Credentials	Ranking	Ranking		
AM Bennet & Company	\$85-\$150	Per-diem unknown	No	2	5	CFE, CIE	2	Two Title Co Target Exams	
Madison, Mroz, PC	\$135 - \$175	No per-diem charged for domestics	Yes	1	4	JD	1	MEGA Life & Health Target Exam	
MR Onstott Consulting Inc.	\$250	\$265	No	2	3	FSA	1	Presbyterian Health Plan Comprehensive Exam	
Noble Consulting	\$75 - \$155	\$90 - \$170	No	2	4	CPA, CFE	2	NM Mutual, SW Casualty, Foundation Reserve Comprehensive Exam	
RL Consulting	\$85 - \$150	No per-diem charged for domestics	Yes	1	15 years	CPA, CFE, CIE	1	Mandated Benefits, Data Call	
Taylor Walker & Associates	\$80 - \$210	\$95 - \$225	No	2	4 years	ACAS, MAAA	1	NM Mutual, SW Casualty, Foundation Reserve Comprehensive Exams	

Source: Insurance Division Examinations Bureau

8 PRINCIPALS INVOLVED - The state may become aware that individuals have had a past history of regulatory noncompliance. The NAIC maintains information systems identifying suspect individuals and past regulatory actions. An examination can identify improper activity prior to its impact on a large number of consumers.

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9 INFORMATION FROM STATISTICS – State may maintain several databases. For example, Missouri law requires the reporting of certain information such as financial statements, premium volume and amounts of claims paid categorized by zip code, malpractice claims, etc. Statistical tests evaluate aberrations that may necessitate further discovery by means of an examination. Illinois and Ohio utilize a market conduct annual statement.

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10 POLICY APPROVAL SUGGESTIONS - The policy analyst may note a trend in policy form filings that may necessitate further discovery by means of an examination.

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11 EVALUATION OF NEW LAW - The state may target an examination in order to determine the compliance with and the effectiveness of recently enacted statutes.

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12 RESULT OF LAST MARKET CONDUCT EXAMINATION - Based upon a review of the findings of a prior examination, the state may determine the need for further review.

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13 MEDIA – States may receive information through news broadcast or the trade journals, which prompt further evaluation.

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14 LEGISLATOR CONCERNS - What feedback have we received from legislators regarding concerns that their constituents have expressed.

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15 REEXAMINATION - REQUIRED UNDERSTANDING AT TIME OF STIPULATION - In order to verify that remedial action has occurred and that the company accomplished full compliance, the state may perform a second examination.

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TOTAL SCORE:

0 0 0 0 0 0

Source: Insurance Division Examinations Bureau