DEPARTMENT OF INSURANCE

It Needs to Make Improvements in Handling Annual Assessments and Managing Market Conduct Examinations

REPORT NUMBER 2003-138, JUNE 2004

Department of Insurance's response as of July 2005

Audit Highlights . . .

Our review of the Department of Insurance's (Insurance) effectiveness in improving consumer services and reducing organized automobile activity through the use of SB 940 and AB 1050 funds and its market conduct examinations found that:

- ☑ ***Insurance lacks adequate data to know how much it should have received from insurers since the enactment of SB 940 and AB 1050. Unaudited data from the Department of Motor Vehicles indicate that Insurance is collecting revenues for far less than the number of registered vehicles in the State, resulting in the possible loss of as much as $7 million in assessments for fiscal year 2002–03 alone.***
- ☑ ***Insurance has not made sufficient efforts to verify that insurers are remitting all revenues due, even though it identified discrepancies in the number of insured vehicles reported by them.***

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The Joint Legislative Audit Committee (audit committee) requested that we assess the Department of Insurance's (Insurance) effectiveness in improving consumer services and its Fraud Division activities as a result of the additional funding it received through SB 940 and AB 1050. Our audit found Insurance does not ensure that it receives all annual assessments due under Chapter 1119, Statutes of 1989 (regular automobile fraud program), Chapter 884, Statutes of 1999 (SB 940), and Chapter 885, Statutes of 1999 (AB 1050). Further, Insurance spent some annual assessment funds on inappropriate activities. The audit committee also requested that we examine the functions of Insurance's bureaus that perform market conduct examinations to determine the efficiency and necessity of having two separate examination bureaus. We found that Insurance would not realize a great deal of time or cost savings by combining its Field Claims Bureau and two Field Rating and Underwriting bureaus that perform market conduct examinations. However, opportunities exist for Insurance to improve management of its market conduct examinations because the Market Conduct Division does not fully utilize Insurance's database and cannot report on the time and cost associated with its examinations.

Finding #1: Insurance has no way of knowing if it receives all assessments due and lacks sufficient oversight for collecting annual assessments.

Insurance lacks adequate data to verify that the amounts insurers remit to it for the three annual automobile assessments constitute all amounts due. Currently, it does not collect complete data on the number of insured vehicles in the State. Lacking complete information on the number of insured vehicles in the State means that Insurance does not know how much it should have received since the enactment of

- ☑ *Despite reducing the backlog of cases in its Investigation Division by 51 percent, Insurance can improve how it reviews and assigns cases to ensure they are not outstanding for long periods of time.*
- ☑ *Insurance cannot easily demonstrate that its Legal Division used SB 940 funds for allowable activities only.*
- ☑ *Insurance could not demonstrate that all AB 1050 expenditures were for allowable activities. Specifically, Insurance spent $22,000 on cases that do not meet the criteria in state law.*
- ☑ *Insurance does not ensure that it follows state laws and regulations for monitoring district attorneys' and the California Highway Patrol's use of AB 1050 funds.*
- ☑ *Its Market Conduct Division does not fully utilize Insurance's database. Therefore, Insurance cannot report on the time and cost associated with its examinations or measure the efficiency of its market conduct operations.*

the regular automobile fraud program, SB 940, and AB 1050. However, it appears that Insurance is collecting assessments for far fewer than the number of registered vehicles in the State, and thus may have missed out on collecting revenues of roughly $7 million due to it during fiscal year 2002–03 alone.

Insurance has not made sufficient efforts to verify that the amounts insurers remit are based on the actual number of vehicles they insure. In May 2003, Insurance's Budget and Revenue Management Bureau analyzed annual assessments received from 349 insurers between calendar years 1998 and 2002 and found that many companies failed to make one or more quarterly payments over the five-year period and that some paid annual assessments for fewer total vehicles in calendar year 2002 than the number of private passenger vehicles they reported having insured to Insurance's Statistical Analysis Division. However, Insurance has yet to follow up with most of these insurers to determine whether they actually underpaid their assessments, and if so, to collect additional amounts that may be due.

We recommended that to ensure it receives all assessments due, Insurance should do the following:

- Move forward in its efforts to make regulatory changes that will result in capturing more specific data from insurers about the number of vehicles they insure.
- Compare the number of private passenger vehicles insurers report on their assessment invoices to the number they report to its Statistical Analysis Division annually and investigate discrepancies.
- Direct its Field Examination Division to follow up on the discrepancies identified in the Budget and Revenue Management Bureau's analysis.
- Periodically perform analytical reviews of insurers' data, such as comparing changes in written premiums to changes in the assessments insurers remit, and investigate unusual trends.

Insurance's Action: Corrective action taken.

Insurance stated new regulations establishing a process that imposes a hard count of the number of vehicles covered by an automobile insurer became effective on July 3, 2005. Additionally, Insurance stated its Field Examination Division has procedures in place for the Budget and Revenue Management Branch to refer insurers to it for limited scope examinations when the Budget and Revenue Management Branch detects problems with the data of the number of insured vehicles and is unable to reconcile or resolve them. Furthermore, Insurance reported that the Budget and Revenue Management Branch established criteria for identifying unusual trends and has incorporated the application of the criteria in its internal procedures. Finally, Insurance reported that its Budget and Revenue Management Branch found it difficult to compare the number of private passenger vehicles insurers report on their assessment invoices to the number they report to its Statistical Analysis Division annually and instead intends to focus on the analysis of unusual trends discussed previously.

Finding #2: Although Insurance has made improvements to consumer services, it cannot demonstrate that it spends all SB 940 funds on allowable activities.

Insurance used the additional staff and resources provided to it by SB 940 to reduce the backlog of open cases in its Investigation Division by 1,580 cases, or 51 percent, since the program's inception. However, Insurance can improve how it reviews and assigns cases to ensure that suspected violations of insurance laws and regulations by agents, brokers, and insurers do not remain unresolved longer than necessary. Further, Insurance used SB 940 funds to increase its outreach and communication efforts related to several automobile insurance programs, and in doing so, may have increased public awareness of the services it provides. However, because the case tracking system used by Insurance's Legal Division is not linked to its time reporting system, Insurance's Legal Division cannot demonstrate that it used the $9.4 million it received in SB 940 funds for only allowable activities.

To improve its services to consumers and provide appropriate oversight of SB 940 funds, we recommended that Insurance do the following:

- Revise its Investigation Division's policies and procedures to ensure that cases are not outstanding for long periods of time. For example, Insurance should assign cases to an investigator as soon as they are received and establish a goal that investigators take no more than a year from the date they receive a case to complete their investigations, barring extenuating circumstances.

- Review its open cases, both assigned and unassigned, to determine whether any should be closed.

- Eliminate the Investigation Division's backlog of unassigned cases by requiring staff to work a reasonable amount of overtime or seeking additional staff.

- Link its Legal Division's case tracking system to its time reporting system to better document the use of SB 940 funds.

Insurance's Action: Corrective action taken.

Insurance reported that it issued a directive to the Investigation Division staff on September 23, 2004, requiring investigators to establish a goal completion date when the initial investigative plan is drafted. During monthly case reviews, supervisors are to monitor investigations and determine if they are proceeding in line with the projected completion date. Insurance also reported that it issued a directive on June 21, 2004, requiring Investigation Division staff to review and assess reports of suspected violations every three months to ensure that the reports are assigned and closed based on their viability. Further, Insurance stated that it received approval to establish five additional investigative positions and these positions have been filled. Insurance plans to monitor the impact that these new positions have on reducing its backlog and, if necessary, seek additional resources in fiscal year 2006–07. Finally, Insurance reported that it implemented a time reporting system in the Legal Division to track time and activity for specific cases, including SB 940 cases. All bureaus have received training in the use of the system and are now using it.

Finding #3: Insurance needs to significantly improve its oversight of AB 1050 funds.

Since its inception, the AB 1050 program has supported a joint approach to investigating 446 organized automobile fraud activity cases, which have led to 432 arrests. However, Insurance used roughly $22,000 in AB 1050 funds to work on 20 cases that do not meet the criteria in state law. Although some cases were initially investigated as AB 1050 cases and later transferred to Insurance's Program for Investigation and Prosecution of Automobile Insurance Fraud (regular automobile fraud program), Insurance did not transfer the expenditures it already incurred on these cases to the regular automobile fraud program. Further, Insurance does not adequately monitor the use of AB 1050 funds by district attorneys receiving grants and by the Department of the California Highway Patrol (California Highway Patrol). Specifically, Insurance did not receive all required reports from district attorneys, and does not follow state regulations that require it to perform a fiscal audit of each county receiving AB 1050 grant funds at least once every three years. Moreover, although state law requires the California Highway Patrol to report annually to Insurance its use of AB 1050 funds, since the inception of the program, Insurance has neither requested nor received these reports. Thus, it cannot ensure that the California Highway Patrol is accurately charging the salaries and benefits of those investigators working on allowable activities under AB 1050.

To ensure that it uses AB 1050 funds appropriately, we recommended that Insurance do the following:

- Transfer the hours and billable expenses it charges to AB 1050 from its organized automobile fraud program when it transfers cases to the regular automobile fraud program.

- Follow state laws and regulations governing fiscal and performance audits of counties to ensure that the district attorneys use AB 1050 funds only for allowable activities and in the most effective and efficient manner.

- Require the California Highway Patrol to submit annual reports of its expenditures as state law requires.

Insurance's Action: Corrective action taken.

Insurance reported that it established new procedures for staff to follow when there is a need to transfer hours and expenditures from one fraud program to another. Insurance stated that it has reorganized the Fraud Grant Audit Unit and approved the hiring of two additional auditors. Insurance stated that it has reorganized its Fraud Division, as well as recruited and hired additional auditors to conduct financial and performance audits of the county district attorney offices that receive grants. Furthermore, Insurance reported that its Fraud Division has continued to improve communications with the California District Attorney Association Insurance Anti-Fraud subcommittee, emphasizing effective reporting of performance measures, improvements in laws and regulations, and the requirements for timely reporting of financial statements. Finally, Insurance reported that it has obtained all annual expenditure reports from the California Highway Patrol for fiscal years 2000–01 through 2003–04.

Finding #4: Combining the Market Conduct Division's bureaus would not likely result in increased efficiencies, but opportunities to improve its management of market conduct examinations exist.

Combining Insurance's Field Claims and two Field Rating and Underwriting bureaus would not greatly reduce either the time or cost to perform market conduct examinations. The objective of the two examinations—claims examination and rating and underwriting examinations—is separate and distinct. Further, the claims examiners and the underwriting examiners possess separate expertise and experience. Thus, combining the three bureaus would require all examiners to become knowledgeable of both types of examinations. However, Insurance could benefit from preparing an analysis to quantify any savings that can be generated from combining administrative tasks such as timekeeping, scheduling and coordinating examinations with insurers, and preparing reports.

To determine whether it could generate savings from combining the administrative tasks of the three bureaus, we recommended that Insurance prepare an analysis and quantify possible savings.

Insurance's Action: Partial corrective action taken.

Insurance stated that it has consolidated the timekeeping of the Field Rating and Underwriting Bureaus and currently one support staff handles this function in each of its bureaus. Additionally, one support staff now handles report publishing for the Market Conduct Division. Insurance believes that its current support staff ratio of 3:41 is reasonable. However, Insurance stated that, as a result of its implementation of a new database, revised duties might evolve and need to be assigned.

Finding #5: Insurance's Market Conduct Division cannot measure the efficiency of its operations because it does not take full advantage of Insurance's database.

Insurance's Market Conduct Division does not take full advantage of Insurance's database and does not adequately capture or tally the time or costs associated with its market conduct divisions; thus, it cannot measure the efficiency of its operations. Insurance's database has modules designed to capture data on insurers licensed to operate in California, including tracking examinations, staff hours, or how much to bill insurers. However, the Market Conduct Division has not taken full advantage of this database's capabilities and the other means this division uses to track examination data are inefficient and do not provide the necessary information.

To ensure that it has sufficient data to assess the efficiency of its Market Conduct Division, including an analysis of the average length of time and cost of its examinations, we recommended that Insurance's Market Conduct Division should work with its Information Technology Division to make full use of Insurance's database. At a minimum, we recommended that the Market Conduct Division's plans should include the following:

- Modifying its examination-tracking module to create an identification number that allows it to identify multiple insurers that are under examination using the existing company identification number.
- Eliminating the need for examiners to manually prepare the monthly timesheets and billing summaries by allowing them to enter their hours directly into the timekeeping module.
- Linking its examination tracking, timekeeping, and accounts receivable modules using the examination identification number.

Insurance's Action: Corrective action taken.

Insurance reported that in March 2005 its Market Conduct Division implemented a new exam tracking system, which includes timekeeping along with integrated expense and billable hour reporting into Accounts Receivables. The exam tracking system's new features will allow the Market Conduct Division to collect exam time and cost information as well as exam results in an automated fashion for a single insurer exam or an insurer group exam by using exam identification numbers.