



Commonwealth of Massachusetts  
Office of the State Auditor  
Suzanne M. Bump

*Making government work better*

Official Audit Report – August 21, 2019

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## Division of Insurance

For the period July 1, 2016 through June 30, 2018





Commonwealth of Massachusetts  
Office of the State Auditor  
Suzanne M. Bump

*Making government work better*

August 21, 2019

Commissioner Gary Anderson  
Division of Insurance  
1000 Washington Street, Suite 810  
Boston, MA 02118

Dear Mr. Anderson:

I am pleased to provide this performance audit of the Division of Insurance. This report details the audit objectives, scope, methodology, finding, and recommendations for the audit period, July 1, 2016 through June 30, 2018. My audit staff discussed the contents of this report with management of the agency, whose comments are reflected in this report.

I would also like to express my appreciation to the Division of Insurance for the cooperation and assistance provided to my staff during the audit.

Sincerely,

A handwritten signature in blue ink, appearing to read "SMB", written over a light blue circular background.

Suzanne M. Bump  
Auditor of the Commonwealth

cc: Edward Palleschi, Undersecretary, Office of Consumer Affairs and Business Regulation

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## TABLE OF CONTENTS

EXECUTIVE SUMMARY .....	1
OVERVIEW OF AUDITED ENTITY .....	2
AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY .....	4
DETAILED AUDIT FINDINGS WITH AUDITEE’S RESPONSE.....	7
1. The Division of Insurance did not bill insurers for \$857,306 in operations assessments.....	7

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## LIST OF ABBREVIATIONS

DOI	Division of Insurance
MMARS	Massachusetts Management Accounting and Reporting System
NAIC	National Association of Insurance Commissioners
OSA	Office of the State Auditor
SRB	State Rating Bureau

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## EXECUTIVE SUMMARY

In accordance with Section 12 of Chapter 11 of the Massachusetts General Laws, the Office of the State Auditor has conducted a performance audit of the Division of Insurance (DOI) for the period July 1, 2016 through June 30, 2018. In this performance audit, we reviewed how DOI administered its operations assessment process and its market conduct analysis of Massachusetts licensed insurers.

Below is a summary of our finding and recommendations, with links to each page listed.

<b>Finding 1</b> <b>Page <u>7</u></b>	DOI did not bill insurers for \$857,306 in operations assessments.
<b>Recommendations</b> <b>Page <u>8</u></b>	<ol style="list-style-type: none"><li>1. DOI should discontinue its practice of excluding some insurers from annual operations assessments and notify insurers that have traditionally been exempt from these assessments that they will no longer be exempt.</li><li>2. DOI should work with insurers that were overbilled for operations assessments to determine whether any restitution is necessary.</li></ol>

## OVERVIEW OF AUDITED ENTITY

The Division of Insurance (DOI), located at 1000 Washington Street in Boston, was established in accordance with Chapter 26 of the Massachusetts General Laws and is one of five agencies overseen by the Office of Consumer Affairs and Business Regulation. DOI operates under the direction of the Commissioner of Insurance, who is appointed by the Governor.

DOI's mission is to regulate the Commonwealth's insurance industry, including but not limited to its domestic<sup>1</sup> and foreign<sup>2</sup> insurers, business entities, health maintenance organizations, insurance producers, and brokers. As of April 2018, there were approximately 1,600 insurers licensed, authorized, or eligible to conduct business in the Commonwealth. According to its website,

*The DOI monitors financial solvency, licenses insurance companies and producers, reviews and approves rates and forms, and coordinates the takeover and liquidation of insolvent insurance companies and the rehabilitation of financially troubled companies. We also investigate and enforce state laws and regulations pertaining to insurance and respond to consumer inquiries and complaints. The DOI provides the public with information regarding various types of insurance through [its] website and assorted publications.*

Annually, DOI receives a budget appropriation from the Massachusetts Legislature (line item 7006-0020), the amount of which is then assessed through the agency's operations assessments upon the insurers it regulates to reimburse the Commonwealth, in accordance with Section 8C of Chapter 26 of the General Laws:

*The commissioner of insurance may make an assessment in each fiscal year against all licensed insurers in the commonwealth. Said assessments shall be made at a rate as shall be determined and certified annually by the commissioner as sufficient to produce revenue to reimburse the commonwealth for funds appropriated for the operation of the division of insurance, hereinafter called the division, less any revenues which were received by the commonwealth under the provisions of section eight B and section fourteen of chapter one hundred and seventy-five, but in no event shall said assessment exceed the sum of two million dollars. Three-fourths of the amount to be so assessed shall be made against all licensed domestic companies and foreign companies in proportion to their net premiums written and annuity considerations in the commonwealth as shown in the annual report of each of said insurers filed with the division;<sup>3</sup> and, in addition, one-fourth of said amount shall be made against all licensed domestic companies in proportion to their net premiums written and annuity considerations as shown in the annual report of each of said insurers filed with the division.*

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1. An insurer incorporated or formed in the Commonwealth of Massachusetts.
  2. An insurer formed by authority of any state or government other than the Commonwealth of Massachusetts.
  3. Also see Appropriations Act line item language discussed on p. 7–8.

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*Said assessment shall reimburse the commonwealth for funds appropriated for the prior fiscal year.*

*Assessments under this section shall be charged to the normal operating cost of each company.*

In addition to the financial solvency of insurers, DOI also monitors how insurers interact with their customers and policyholders to ensure that they are treated fairly and in accordance with contracts, state laws, and regulations. DOI's Market Conduct Team accomplishes this through both comprehensive and limited-scope examinations. These examinations include staff interviews and reviews of various processes within an insurer, the results of which are documented in a report issued by DOI. These examinations are discretionary; they are typically conducted with a financial examination of the state's domestic insurers.

Because DOI can only complete a limited number of comprehensive exams annually, the Market Conduct Team continually performs market conduct analyses of numerous insurers throughout the year. The team uses information from the National Association of Insurance Commissioners (NAIC) to examine business practices such as ratings, policy underwriting, policy cancellations, claim settlements, and advertising. NAIC provides DOI with a summary of this information, identifying insurers that are outliers in various areas that may pose a potential risk to consumers. Market conduct analysis allows DOI to identify insurers that warrant further inspection or, in some cases, regulatory action.

DOI had a staff of 129 employees at the end of fiscal year 2017 and 123 employees at the end of fiscal year 2018. The staff included professionals such as attorneys, auditors, accountants, insurance examiners, and support personnel. DOI's appropriations for fiscal years 2017 and 2018 were \$13.6 million and \$13.3 million, respectively.

## AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with Section 12 of Chapter 11 of the Massachusetts General Laws, the Office of the State Auditor (OSA) has conducted a performance audit of certain activities of the Division of Insurance (DOI) for the period July 1, 2016 through June 30, 2018. We expanded our audit period for the audit objective related to DOI's operations assessments to July 1, 2013 through June 30, 2018.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Below is a list of our audit objectives, indicating each question we intended our audit to answer; the conclusion we reached regarding each objective; and, if applicable, where each objective is discussed in the audit findings.

Objective	Conclusion
1. Does DOI properly administer its operations assessment process?	No; see Finding <u>1</u>
2. Does DOI properly administer its market conduct analysis of Massachusetts licensed insurers?	Yes

To achieve our objectives, we gained an understanding of the internal controls related to our audit objectives by reviewing applicable laws and agency policies and procedures, as well as conducting interviews with DOI management. We evaluated the design and tested the operating effectiveness of controls over DOI's market conduct analysis of licensed insurers in the state.

### Data Reliability

In 2018, OSA performed a data reliability assessment of the Commonwealth's Massachusetts Management Accounting and Reporting System (MMARS) that focused on testing selected system controls (access controls, application controls, configuration management, contingency planning, and segregation of duties) for the period April 1, 2017 through March 31, 2018. In conjunction with this



work, we tested security management controls at DOI during the audit period to assess security awareness training and personnel screening.

We performed validity and integrity tests on the MMARS data, including (1) scanning for duplicate entries, (2) looking for dates outside the audit period, and (3) testing for blank fields.

We then compared the MMARS data to DOI's original invoices to determine the accuracy of the records. We judgmentally selected 30 transactions from MMARS and determined whether the information from MMARS matched the original invoices. Next, we judgmentally selected a sample of 30 original invoices from DOI's files and traced the information on the invoices to the data in MMARS.

We inspected an Excel workbook DOI provided to us that contained a list of insurers that received operations assessments in fiscal years 2014 through 2018. We examined this workbook and tested for macros, hidden rows and columns, and hidden worksheets. We performed additional validity and integrity tests, including (1) checking total amounts against agency totals, (2) testing for missing records or missing values in key data elements, (3) scanning for duplicate entries, (4) verifying fields to detect any data validity errors, and (5) testing for values outside a designated range.

We requested documents related to the market conduct analysis that DOI performed on insurers it regulated during the audit period. To test the accuracy and completeness of these documents, we met with DOI officials and a third-party consultant to verify that we had received all documents for market conduct analyses performed during the audit period.

Based on the results of these data reliability assessment procedures, we determined that the information obtained for our audit period was sufficiently reliable for the purposes of our audit work.

## **Operations Assessments**

To determine whether DOI properly administered its operations assessment process, we reviewed all applicable authoritative requirements for this process (Section 8C of Chapter 26 of the General Laws, DOI's policies and procedures, and DOI's annual budget appropriations). Then, for 100% of the insurers listed on DOI's operations assessment Excel workbook, we reviewed all the invoices related to these assessments to determine whether all insurers that were required to receive operations assessments did so and whether the amounts of the fees were accurately calculated.

## **Market Conduct**

To determine whether DOI properly administered its market conduct analysis of Massachusetts licensed insurers in accordance with Section 4(3) of Chapter 175 of the General Laws and with the National Association of Insurance Commissioners' *Market Regulation Handbook*, we selected 100% of insurers that received a market conduct analysis from DOI during the audit period.

We reviewed DOI's market conduct analysis and determined whether DOI performed a baseline analysis of all insurers identified as outliers. For the purpose of this audit, a baseline analysis is a review performed by DOI's Market Conduct Team to determine whether insurers identified as outliers require further examination. Based on this review, we examined whether DOI then performed either a level 1 analysis (an evaluation of an insurer to determine whether it can sufficiently explain why it was an outlier) or an interrogatory review (an evaluation of answers to interview questions that DOI has sent to an insurer to determine its compliance with state or federal laws) and whether this was evidenced by a letter from DOI to the outlier insurer detailing the type of review.

## DETAILED AUDIT FINDINGS WITH AUDITEE'S RESPONSE

### 1. The Division of Insurance did not bill insurers for \$857,306 in operations assessments.

In fiscal years 2014 through 2018, the Division of Insurance (DOI) did not bill 62 out of a total of 5,816 insurers for \$857,306 in annual operations assessments even though the insurers were required to pay them. As a result, DOI overbilled the remaining insurers to which it assessed annual operations assessments, as indicated below.

#### DOI Operations Assessments by Fiscal Year

Fiscal Year	Assessments Sent	Insurers Excluded from Assessments	Amount Overbilled to Assessed Insurers
2018	1,156	14	\$ 198,743
2017	1,147	13	186,437
2016	1,149	13	180,042
2015	1,153	12	162,341
2014	1,149	10	129,744
Total	<u>5,754*</u>	<u>62</u>	<u>\$ 857,306<sup>†</sup></u>

\* This number does not represent an unduplicated count of insurers; some insurers may have been assessed in multiple years.

† Discrepancies in totals are due to rounding.

### Authoritative Guidance

Section 8C of Chapter 26 of the Massachusetts General Laws states that DOI assessments made in each fiscal year are against all licensed insurers in the Commonwealth. Additionally, line item 7006-0020 in the Commonwealth's budget summaries for fiscal years 2014–2018 reads as follows:<sup>4</sup>

*For the operation of the division of insurance . . . provided, that notwithstanding any general or special law to the contrary, 100 per cent of the amount appropriated in this item . . . shall be assessed upon the institutions which the division currently regulates pursuant to general or special laws or regulations . . . and provided further, that the assessment shall be in addition to any assessments currently assessed upon those institutions.*

Also, Section 7A of Chapter 26 of the General Laws states, "The [operational] assessment shall be allocated on a fair and reasonable basis among all carriers."

4. This quotation is from the 2018 budget, but the line item exists with only minor differences in wording in the previous four years' budgets.

Further, the Office of Consumer Affairs and Business Regulation's *Division of Insurance Assessment Calculation and Billing Procedures* states that DOI is required to do the following for operations assessments:

*Allocate the assessment on a fair and reasonable basis among all insurers licensed, admitted, authorized or approved by the commissioner. The Division evenly distributes the assessment among the companies based on their license/certificate status.*

## Reasons for Issue

DOI officials pointed out that the division had a longstanding practice of not billing some insurers for annual operations assessments. DOI management stated that DOI excluded insurers from annual operations assessments if the amounts it received from an insurer for other assessments (for example, the State Rating Bureau [SRB] medical malpractice assessment and the SRB Workers Compensation Rating and Inspection Bureau assessment) exceeded what would be its annual operations assessment. However, this practice is not required by statute or the agency's internal policies and procedures. Further, DOI officials informed us that, before they were informed of this audit, the division had established a working group related to the operations assessment process. As a result of a recommendation from the working group, DOI's commissioner determined that the agency would notify companies that had traditionally been exempt from operations assessments that they would no longer be exempt starting in fiscal year 2019. However, as of the end of our audit fieldwork, DOI had not sent out these notifications.

## Recommendations

1. DOI should discontinue its practice of excluding some insurers from annual operations assessments and notify insurers that have traditionally been exempt from these assessments that they will no longer be exempt.
2. DOI should work with insurers that were overbilled for operations assessments to determine whether any restitution is necessary.

## Auditee's Response

*For each fiscal year during the audit period, the DOI was charged with collecting the amount appropriated for its operations in accordance with the applicable budgetary language, . . . instructions from the Office of Consumer Affairs and Business Regulation, and DOI's own policies and procedures then in effect. . . . DOI assessed licensed insurance companies 100% of the amount indicated for the operations assessment for each fiscal year, and no portion of any operations assessment was not billed by DOI during the audit period. . . .*

*No insurers were "overbilled." While the DOI did not assess certain insurers during the audit period . . . the DOI did bill insurers that "were required to pay." The annual budgetary provisions are the controlling statutory authority for the DOI to administer the operations assessment. . . . This budgetary language does not dictate how the assessment must be made; rather, it provides the DOI with the discretion to calculate, bill and collect the operations assessment in the manner in which it did, including the application of the "maxed-out" exclusion policy. . . .*

*The DOI formed an assessment working group in April 2017 for the purpose of updating its comprehensive Assessment Calculation and Billing Procedures Manual, which had last been revised in November 2008. In December 2017, the DOI assessment working group recommended that the "maxed-out" exclusion policy be discontinued, consistent with the recommendation of the draft audit report. . . .*

*The "maxed-out" exclusion policy avoided a circumstance in which a small number of insurers would be paying to support the DOI's general operations and, at the same time, supporting the DOI's operations through two separate assessments that fund the State Rating Bureau, which is a core unit of the DOI. At all times, the operations assessment has been administered in accordance with DOI's Assessment Calculation and Billing Procedures, which requires the DOI to "[a]llocate the assessment on a fair and reasonable basis among all insurers."*

## **Auditor's Reply**

Although DOI asserts in its response that it has the discretion to calculate and collect the assessments the way it did, there is nothing in Section 8C of Chapter 26 of the General Laws, budgetary language, or any other authoritative guidance that allows DOI to exempt the agencies in question from paying the assessments if they meet an exclusion threshold DOI says it has established. In fact, as noted above, the budgetary language specifically states that "the assessment shall be in addition to any assessments currently assessed upon those institutions." Moreover, as noted above, the "maxed-out" exclusion policy that DOI said it was following does not exist in agency policies or procedures; it was therefore unclear to the Office of the State Auditor (OSA) why this billing practice was followed. Although we do not dispute the fact that DOI may have collected sufficient amounts through these assessments to cover what was appropriated for its operations in accordance with the applicable budgetary language, OSA believes that DOI should have complied with the Office of Consumer Affairs and Business Regulation's *Division of Insurance Assessment Calculation and Billing Procedures* to allocate the assessment fairly among all insurers, not just a subset. By not doing this, DOI clearly overbilled the insurers that did receive annual operations assessments in an amount equal to what it should have billed to the insurers it should not have excluded. For example, as noted above, in fiscal year 2018, DOI should have billed 1,170 insurers for operations assessments but instead only billed 1,156 of these insurers. Consequently,

DOI effectively shifted the operations assessment costs of \$198,743 that needed to be collected from the 14 excluded insurers to the 1,156 insurers that were charged an operations assessment, resulting in these 1,156, on average, paying \$171.92 more ( $\$198,743/1,156$  insurers) than they should have if DOI had not excluded any insurers.

Based on its response, DOI is taking measures to address our concerns in this area.