REPORT OF

THE

STATE AUDITOR

ENFORCEMENT FUNCTIONS AT THE DIVISION OF INSURANCE

PERFORMANCE AUDIT
JANUARY 1999

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January 7, 1999

Members of the Legislative Audit Committee:

This report contains the results of a performance audit of enforcement functions at the Division of Insurance at the Department of Regulatory Agencies. The audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of state government. This report presents our findings, conclusions, and recommendations, and the responses of the Division of Insurance and Department of Law.

J. David Barba

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STATE OF COLORADO
OFFICE OF THE STATE AUDITOR **REPORT SUMMARY**

J. DAVID BARBA, CPA
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ENFORCEMENT FUNCTIONS AT THE DIVISION OF INSURANCE PERFORMANCE AUDIT January 1999

Authority, Purpose, and Scope

This performance audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the Office of the State Auditor to conduct performance audits of all departments, institutions, and agencies of state government. The audit was conducted in accordance with generally accepted government auditing standards. Our procedures included reviewing documentation pertaining to enforcement activities; interviewing and surveying staff at the Division of Insurance and the Department of Law; surveying agents, companies, and consumers; and analyzing data from Colorado and from peer states. Audit work was conducted by the firm of Sonnenschein, Nath & Rosenthal between April and September 1998.

In 1997 the Legislative Audit Committee requested that the State Auditor conduct a performance audit of enforcement functions at the Division of Insurance. On the basis of the Committee's concerns and other information, we reviewed the following:

- Data from peer states regarding resources, staffing, and enforcement results.
- Staffing and workflow within the Division's enforcement-related units.
- Procedures and guidelines for conducting enforcement activities.
- External and internal communications regarding enforcement.

We gratefully acknowledge the assistance and cooperation of staff at the Division of Insurance and the Department of Law. The following summary provides highlights of the comments and recommendations contained in this report.

For further information on this report, contact the Office of the State Auditor at (303) 866-2051.

Overview

The Division of Insurance (Division) is an agency within the Department of Regulatory Agencies. It is administered by the Commissioner of Insurance, who is appointed by the Governor with Senate confirmation. To fulfill its stated mission of protecting the State's insurance consumers, the Division licenses and oversees the activities of Colorado's 93 domestic and 1,399 foreign insurance companies, 50,373 insurance producers (i.e., agents or brokers), and 473 licensed bail bondsmen. In Fiscal Year 1998 the Division employed about 95 FTE and spent about $7.4 million performing these and other functions (e.g., public education).

Our audit focused on the Division's enforcement functions. Enforcement activities are conducted primarily by the Division's Market Conduct, Consumer, Investigations, and Financial Analysis and Examination Sections. These units respond to consumer complaints and conduct various types of investigations and examinations (e.g., market conduct examinations and solvency reviews). In 1997 the Division reported that it returned almost $10.5 million to consumers as the result of its enforcement and advocacy efforts.

We noted that the Division has recently made two key improvements in its enforcement-related processes. First, in January 1998 the Division issued a policy (i.e., Bulletin 1-98) that established a standardized methodology for sanctioning and penalizing entities found to be in violation of Colorado's insurance laws and regulations. Establishing a standardized policy for dealing with violators should result in a more consistent, fair, and predictable approach for imposing fines and penalties. We also noted that the Division is in the process of converting to a new computerized regulatory information system (i.e., COSMOS) that will assist staff in compiling and monitoring enforcement-related information. According to Division staff, COSMOS will be an improvement over the systems and processes formerly used in the agency to track enforcement information.

Comparison of Enforcement Functions With Peer States

Part of our audit included a comparison of the Division's main enforcement activities and those conducted by similar agencies in other states. To facilitate this analysis, we used 1996 data (the most recent data available) contained in the National Association of Insurance Commissioners' (NAIC) *Insurance Department Resources Report.* For comparison purposes, we chose ten peer states (i.e., Alabama, Arizona, Arkansas, Kansas, Maryland, Minnesota, Oklahoma, Oregon, Washington, and Wisconsin), which were selected on the basis of state population, insurance department/division budget, number of admitted insurers, premium volume, and other factors.

Overall, we found that Colorado took fewer formal enforcement actions against insurers in 1996 than its peer states did (i.e., 17 actions vs. an average of 35). Colorado's performance in this area could be due to differences in enforcement strategies (i.e., preference for a less formal, problem-solving enforcement approach vs. a traditional, punishment-oriented approach) or variations in the tools available for resolving problems (e.g., the absence or presence of an effective alternative dispute resolution system).

Our analysis of the Division's enforcement actions by organizational unit showed that Colorado's activity levels are sometimes higher and sometimes lower than peer states. For example, in terms of the percentage of admitted insurers receiving a market conduct examination, Colorado's coverage was above average and fourth highest among its peer states. Conversely, Colorado completed financial examinations of only 11.8 percent of Colorado-domiciled insurers in 1996 and ranked seventh among the peer state group.

None of the data obtained from the comparative analysis clearly show that there are major problems in the way Colorado conducts its enforcement-related activities, even though the Division can make certain operational changes to improve aspects of its performance (these issues are discussed in more detail below). Differences in state insurance laws, regulatory environments, and other factors will impact comparisons even among those states that have been chosen for their overall similarity. However, it may be helpful for the Division to periodically review and analyze data such as those presented in the NAIC's *Insurance Department Resources Report* or similar publications to assess where it stands in comparison with other states. Such a review could help the Division identify areas that may need more or less enforcement emphasis. Another approach that the Division should consider is reviewing the approaches used in states that have a reputation for strength and then using these comparisons to set operational benchmarks and goals for its enforcement program. The Division of Insurance should periodically assess how its enforcement-related functions and activities compare with industry standards and best practices. Data derived from this analysis should be used as a starting point for developing goals and objectives for the Division's enforcement program.

Review of Specific Enforcement Activities

As part of our audit we also reviewed key activities performed by individual Division units with enforcement responsibilities. Audit procedures included reviewing the adequacy and appropriateness of the procedures used to initiate and conduct enforcement activities; the usefulness of systems used to prioritize examinations and investigations of entities that have been identified as problematic; the responsiveness of enforcement activities and actions; and the adequacy and appropriateness of the sanctions available to discipline violators. Whenever possible, we used accepted industry standards (e.g., NAIC guidelines) as our gauge of whether a procedure or process was adequate.

Our audit showed that some operational improvements were needed in all of the organizational units that deal with enforcement issues. Specifically:

- Methods for prioritizing financial examinations need to be automated and tailored to meet Colorado-specific conditions. By making these changes, the Division can provide better monitoring of the solvency status of insurers doing business in the State.

- Existing methods for conducting market conduct examinations (e.g., desk audits and extensive on-site reviews) need to be expanded to include an intermediate level of review. By conducting short-term, issue-specific market conduct examinations, the Division can improve its coverage of the entities it regulates and spend less time and fewer resources on routine examinations that may delve into less important issues.

- Procedures for responding to complaints and conducting investigations need to be updated. Further, methods for prioritizing workload need to be revised so that consumer complaints and inquiries are handled according to objective criteria (e.g., potential harm to the consumer, impact on the insurance marketplace).

- Individual workload measures need to be developed and instituted for all staff who have enforcement-related responsibilities. Establishing standards will help Division management review and compare individual workload and performance and will assist in the implementation of Colorado Peak Performance, which is scheduled for Fiscal Year 2000.

- Methods for communicating with outside parties (e.g., consumers, the insurance industry, and the general public) need improvement. A survey of outside parties that we conducted showed, for example, that the Division needs to provide more information to insurers about its methods for calculating fines and penalties. Improving communication in this area and other areas should raise awareness of the Division's enforcement functions and could result in better compliance rates.

The Division should implement improvements in all of these operational areas.

Interaction With the Department of Law

Another part of our review examined how the Division works with the Department of Law to carry out certain enforcement activities. Many enforcement actions that the Division undertakes require the use of attorneys (e.g., developing agreements with regulated entities about the actions needed to address a violation or violations). The Division's legal services are provided by attorneys and paralegals who work for the Department of Law.

Improved cooperation between the Division and the Department of Law could help ensure that the Division's enforcement activities are conducted as efficiently and effectively as possible. For example, the Division's process for disciplining entities found to be in violation of laws or regulations is cumbersome and time-consuming. **By working with the Department of Law to develop standardized consent orders for dealing with routine, reoccurring enforcement actions, the**

Division can maximize the efficiency of its disciplinary process. Further, the Division should develop a more systematic alternative dispute resolution process to ensure timely resolution of smaller-scale violations.

We also found that better communication between Division and Department of Law staff is needed to ensure enforcement-related cases are handled as expected. For example, allowing more participation by attorneys rather than just management staff in the monthly meetings that are held to apprise Division staff of the status of cases would help ensure complete and timely information exchange. Further, providing case preparation training for Division staff would help alleviate problems that now exist with the referral of incomplete or insufficient cases to the Department of Law. **By working with the Department of Law to facilitate changes in these and other areas, the Division can help ensure timely and appropriate responses to enforcement-related cases that require legal expertise.**

Summary of Division of Insurance Responses to the Audit Recommendations:

The Colorado Division of Insurance agrees with the recommendations put forth in this performance audit to make improvements in its enforcement functions. Assessing the effectiveness of regulatory enforcement is very difficult since, as the report rightly points out, regulatory climates vary considerably from state to state, with some focused more on imposing monetary sanctions and others aimed at problem solving. Colorado's legal fining authority has been moderate compared to many states, which has resulted in a strong emphasis at gaining compliance through making the consumer "whole." With the advent of the market conduct program, however, the Division now has systematic compliance examinations that have dramatically improved its regulatory effectiveness. The field work for this state audit focused on 1996 and 1997 enforcement actions. However, in 1998, the Division conducted over 40 audits, 45 market conduct examinations (in some phase of the exam process), and assessed $1.1 million in market conduct fines. These efforts underlie the growing enforcement-related successes as well as the more efficient deployment of resources within the Division. The Division welcomes the recommendations made in this report to improve operations and will work expeditiously to ensure their implementation.

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
1	22	Periodically assess how enforcement-related functions compare with industry standards and best practices.	Division of Insurance	Agree	12/31/99 and annually thereafter
2	26	Develop a Colorado-specific early-warning system, and use this information to augment processes already in place for prioritizing financial examinations.	Division of Insurance	Agree	12/31/99
3	29	Use short-term, issue-specific market conduct examinations to increase enforcement coverage.	Division of Insurance	Agree	11/98 initiated process
4	32	Update the Guidelines Manual and formally adopt proposed procedures for the Investigations Section.	Division of Insurance	Agree	12/31/99
5	33	Develop a comprehensive prioritization system for all complaints received and handled by the Division.	Division of Insurance	Agree	9/30/99
6	34	Develop objective individual workload measures for staff in the Market Conduct, Consumer, and Investigations Sections.	Division of Insurance	Agree	6/30/99
7	38	Work with the Department of Law to restructure disciplinary processes to maximize efficiency.	Division of Insurance Department of Law	Agree Agree	6/30/99
8	39	Work with the Department of Law to ensure Division priorities are clearly determined and communicated.	Division of Insurance Department of Law	Agree Agree	6/30/99
9	41	Work with the Department of Law to ensure case files are referred with sufficient information.	Division of Insurance Department of Law	Agree Agree	1/15/99
10	41	Ensure that staff involved with investigations-related functions are adequately trained in case development, documentation, and preparation.	Division of Insurance Department of Law	Agree Agree	6/30/99
11	44	Pursue various improvements in the methods used to communicate with consumers, the insurance industry, and other external parties.	Division of Insurance	Agree	12/31/99

Description of the Division of Insurance

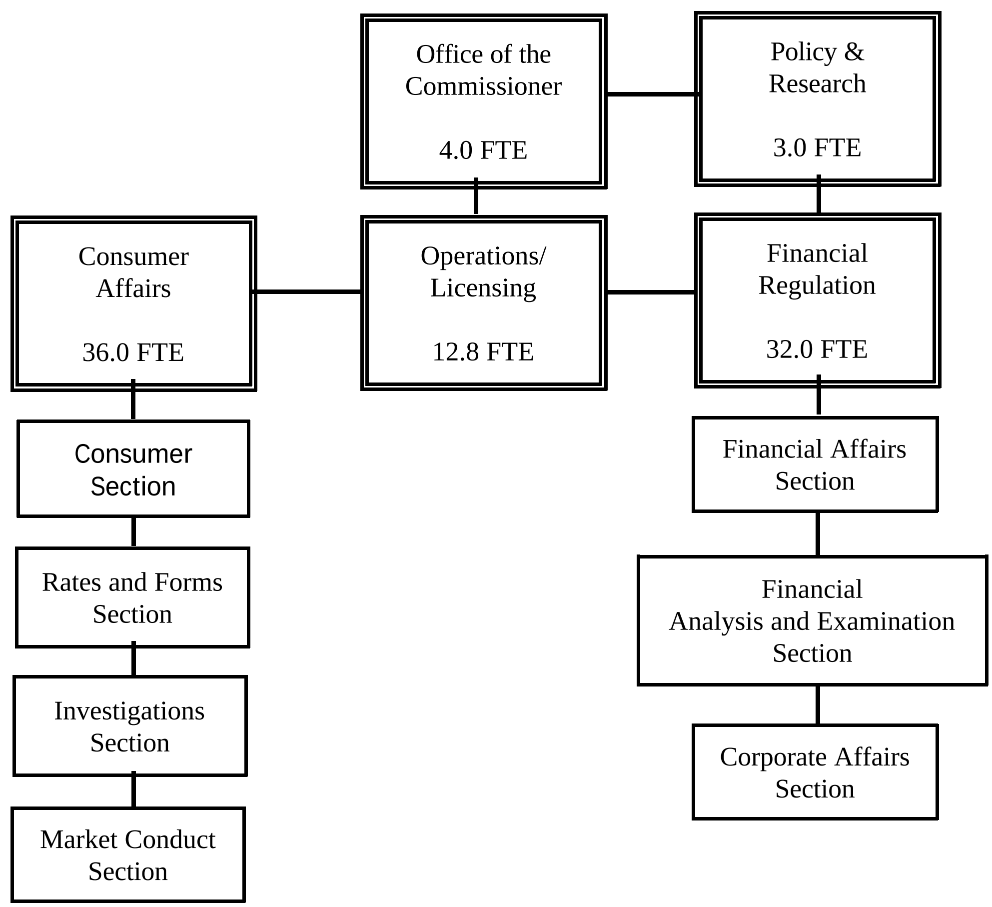
Overview

The Division of Insurance (Division) is an agency within the Department of Regulatory Agencies. The Division is administered by the Commissioner of Insurance, who is appointed by the Governor with Senate confirmation. In Fiscal Years 1996 and 1997 the Division's expenditures were steady at about $6.3 million, which included 88 FTE. According to budget documents, Division expenditures increased to about $7.4 million and staffing increased to over 95 FTE in Fiscal Year 1998. The Division is almost entirely cash-funded through taxes on insurance premiums and fees from business registrations and licenses. The Division also receives a small amount of federal funds each year (about $130,000).

The Division's stated mission is the protection of Colorado's insurance consumers. Accordingly, in 1997 the Division admitted, licensed, supervised, and enforced Colorado's laws and regulations as they applied to 93 domestic and 1,399 foreign insurance companies, 50,373 insurance producers (i.e., agents or brokers), and 473 licensed bail bondsmen.

As indicated in the following chart, the Division is organized into four primary functional areas. The Division's enforcement functions, which were the focus of this audit, are conducted primarily by the Consumer Section, Investigations Section, Market Conduct Section, and Financial Analysis and Examinations Section. A detailed description of each of these sections and its enforcement functions follows.

Division of Insurance - Organizational Chart
Fiscal Year 1997



Source: Division of Insurance.

Consumer Section

The Consumer Section addresses written, electronic, and telephone complaints and inquiries from consumers. It also conducts protest hearings regarding automobile insurance rate issues. The Consumer Section had 19 FTE in Fiscal Year 1997.

Investigations Section

The Investigations Section manages and conducts investigations into insurers' practices including illegal or unauthorized activity and misleading or deceptive sales practices. The Section receives cases from the Market Conduct Section, Consumer Section, or directly from management but is not necessarily involved in all cases or complaints handled by the Division. Investigators work with the Department of Law, law enforcement agencies, other investigative agencies, and the National Association of Insurance Commissioners (NAIC). The Investigations Section had 4 FTE in Fiscal Year 1997.

Market Conduct Section

The primary function of the Market Conduct Section is to perform on-site compliance examinations and desk audits of admitted insurance companies. On-site market conduct examinations are the method by which the Division reviews various business functions of an insurance company to ensure that the company is treating consumers fairly and complying with state laws and regulations. These reviews generally center around a particular line of business (e.g., operations related to a company's property and casualty insurance products).

Another examination and enforcement tool used by the Market Conduct Section is the desk audit. A desk audit consists of reviewing all records regarding consumers or policies that may have been affected by certain company practices over a specific period of time. Desk audits are a far less resource-intensive method of verifying or investigating company compliance than conducting an on-site market conduct examination. This Section had 2 FTE at the start of 1997 and, in July 1997, the General Assembly approved funding for 7 additional FTE. The unit also has approximately 14 independent contract examiners at its disposal to assist in its operations.

Financial Analysis and Examination Section

This Section conducts financial examinations (i.e., solvency reviews) of domestic insurance companies. The Division's financial examination staff consists of a Chief Examiner, 12 examiners, and an Information Systems Auditor. The Division uses contract examiners to augment this staff as needed. In 1997 one contract examiner was used. The Division planned to have five examinations performed by contract examiners in 1998.

Overall Enforcement Activity – Fiscal Year 1997

During Fiscal Year 1997 the Division reported that it performed the following enforcement-related activities:

- Processed admissions for 19 insurance companies.
- Issued 3,458 resident agent licenses.
- Issued 6,071 nonresident agent licenses.

- Revoked two agent licenses.
- Conducted 15 market conduct examinations of insurance companies.
- Investigated the practices of 686 insurance agents.
- Investigated the practices of 244 bail bondsmen.
- Completed examinations of the financial condition of 14 domestic insurers.
- Handled 7,628 consumer complaints and 1,498 information-only inquiries.

In addition to performing these activities, the Division reports the following actual dollars were returned to consumers as a result of the agency's advocacy efforts:

Dollars Returned to Colorado Consumers – 1997
Division of Insurance

Unit or Section Handling the Complaint or Case	Dollars	% of Total
Life, Accident, and Health Unit (Consumer Section)	$ 5,558,456	53 %
Property and Casualty Unit (Consumer Section)	$ 3,190,467	30 %
Investigations Section	$ 1,712,442	16 %
Market Conduct Section [1]	$ 37,561	< 1 %
TOTAL	**$10,498,946**	**100 %**

Source: Division of Insurance.
[1]**Note**: This section did not routinely capture these data until recently. Therefore, figures shown here for 1997 are incomplete.

Comparison of Enforcement Functions With Peer States

Chapter 1

Overview

On the basis of 1996 premium volume, Colorado's insurance industry ranks thirty-fourth in size in the United States. When comparing Colorado's insurance industry based upon the number of admitted insurers in 1996, however, the State ranks twenty-sixth. For the purpose of evaluating the Colorado Division of Insurance (Division) in comparison with other states, we selected and obtained various data from ten "peer states." The data used in this report were obtained from the National Association of Insurance Commissioners (NAIC) as reported in the *Insurance Department Resources Report - 1996.* This report is based on 1996 data provided to the NAIC by state-level insurance departments/divisions. These data are the most recent, uniformly reported, compiled, and tested data available. Permission for use of these data in this report has been granted by the NAIC.

The following factors were considered in the selection of Colorado's ten peer states:

- State population.
- Annual insurance department/division budget.
- Total number of licensed/admitted insurers in the state.
- Total annual insurance premium volume written in the state.
- Total number of financial and market conduct examinations conducted in the reporting year.
- Total number of consumer complaints received in the reporting year.

On the basis of these factors, Colorado's ten peer states are Alabama, Arizona, Arkansas, Kansas, Maryland, Minnesota, Oklahoma, Oregon, Washington, and Wisconsin.

It should be noted that comparing Colorado data with that of other states also requires analysis of the differences among states' laws, as well as other factors. For example, Colorado is one of only four states in the country that has a protest law. The other states are Maryland, Virginia, and Massachusetts. This law requires insurance companies that provide particular types of coverage to furnish written notification to policyholders that they have an automatic right to protest certain actions their insurer may take (e.g., rate increases and coverage cancellations). These protests are handled by the Division. Further, the structure of each state's insurance department/division varies (e.g., some insurance commissioners are elected and others, like Colorado's, are appointed). The audit results account for these differences and others whenever possible.

Funding Comparisons

The Division's annual budget of about $6.3 million ranked twenty-fifth nationally in 1996. Among Colorado's ten peer states, it has the fifth largest budget and the eighth highest number of admitted insurers. Colorado has the fourth highest budget per insurer admitted among its peer states. These data suggest that Colorado's Division is operating with average budgetary resources when compared with its peer states. The following table compares resources on the basis of premium volume and admitted insurers among Colorado and its peers.

Comparison of State Agency Resources By Premium Volume and Admitted Insurers Colorado and Peer States

State	Premium Volume	1996 Budget	Premium Volume/ Budget	1996 Admitted Insurers			Budget/ Number of Insurers
				Domestic	Foreign	Total	
Alabama	$10,579,093,120	$5,488,073	$1,928/$1	96	1,402	1,498	$3,664
Arizona	$11,721,092,245	$4,641,400	$2,525/$1	555	1,564	2,119	$2,190
Arkansas	$5,025,282,683	$5,233,063	$960/$1	82	1,419	1,501	$3,486
Colorado	$12,379,394,975	$6,254,672	$1,979/$1	93	1,399	1,492	$4,192
Kansas	$6,615,156,358	$7,166,627	$923/$1	54	1,452	1,506	$4,759
Maryland	$14,234,312,917	$15,045,775	$946/$1	105	1,380	1,485	$10,132
Minnesota	$14,129,811,682	$6,006,215	$2,353/$1	213	1,219	1,432	$4,194
Oklahoma	$6,309,045,092	$5,832,880	$1,082/$1	123	1,469	1,592	$3,664
Oregon	$9,315,080,492	$5,643,916	$1,650/$1	110	1,463	1,573	$3,588
Washington	$15,822,017,059	$10,675,036	$1,482/$1	81	1,310	1,391	$7,674
Wisconsin	$15,365,694,791	$6,872,500	$2,236/$1	350	1,460	1,810	$3,797

Source: Sonnenschein, Nath & Rosenthal analysis of NAIC data.

Overall Enforcement Record

In 1996 the Division took 17 reported actions against insurance companies. The average among Colorado's peer states is 35, making Colorado lower than average by a significant degree. The following chart demonstrates these figures.

Enforcement Actions Taken Against Insurers in 1996

	Formal Disciplinary Hearings	Certificate of Authority		Other Enforcement Actions				
		Suspended	Revoked	Cease & Desist	Consent Order	Supervision	All Others[1]	Total
Alabama	3	13	3	2	0	0	0	18
Arizona	0	9	0	0	22	2	3	37
Arkansas	7	27	3	7	11	0	49	98
Colorado	0	3	0	4	8	0	2	17
Kansas	2	1	0	7	7	0	0	15
Maryland	3	2	1	2	0	0	0	5
Minnesota	2	N/A	2	1	40	0	2	74
Oklahoma	4	0	0	1	16	0	55	72
Oregon	0	3	5	1	18	0	0	27
Washington	0	0	0	4	0	0	0	4
Wisconsin[2]	69	0	0	0	0	0	0	0

Source: Sonnenschein, Nath & Rosenthal analysis of NAIC data.
[1]**Note**: These include letters of agreement and various types of "voluntary" actions (e.g., contributing to a consumer education fund) that a company may take to remedy a problem.
[2]**Note:** Wisconsin did not report data on any of the above items except formal disciplinary hearings.

Differences in the number of disciplinary actions taken by states may be the result of a number of factors. For example, in resolving disputes, Colorado's enforcement strategy focuses first on making the consumer "whole" and second on changing an insurer's actions. Traditional disciplinary actions are taken once the first two priorities have been met and usually only when an equitable remedy has not been provided by the company. Other states use disciplinary actions differently in that they impose fines and/or issue consent orders as a primary tool for remedying disputes and other violations. Colorado's current enforcement strategy, therefore, may be one reason why it does not compare as favorably with other states in terms of the number of formal enforcement actions alone.

We also noted that Colorado, like three of its peer states, did not report that it conducted any formal enforcement-related hearings in 1996. These data reflect conventions that are present in a particular state in that some states (e.g., Wisconsin) use the hearing process early in the disciplinary system, whereas others (e.g., Colorado, Arizona, Oregon, and Washington) use hearings as a last resort once other avenues of dispute resolution have failed. This practice of using formal hearings as only a last resort may be more cost-effective as long as the results are acceptable. This is because formal hearings are generally more expensive to conduct than alternative methods of dispute resolution.

Analysis of Enforcement Activities by Organizational Unit

We also conducted a more detailed comparison of Colorado's enforcement activity with the levels of activity in other states. Specifically, we compared activity levels in regard to the major enforcement tools now in use by the Market Conduct, Consumer, and Financial Analysis and Examination Sections. Data to compare the activities of one of Colorado's main enforcement units **S** the Investigations Section **S** were not available because the NAIC does not collect discrete data on the investigations function. This is because many states do not conduct their investigations from a separate organizational unit (i.e., each major enforcement unit conducts its own investigations activities). The following discussion outlines our observations in regard to each organizational area.

Market Conduct Section

The Division reports that the total cost for all market conduct activities performed in 1996 was about $505,000. This figure includes the cost of contract examiners (about $320,500) and state-funded examiners (about $184,500).

The following table shows a comparison of market conduct examination activity in Colorado and its peer states during 1996.

Analysis of 1996 Market Conduct Examination Activities							
Number of Full-Time Examiners[1]				**Number of Examinations**			
State	State FTE	Contract FTE	Total FTE	# Initiated	# Initiated/ Examiner	# Completed	# Completed/ Examiner
Alabama	0	0	0	0	--	0	--
Arizona	0	32	32	56	1.8	50	1.6
Arkansas	2	0	2	0	0.0	0	0.0
Colorado	**2**	**0**	**2**	**9**	**4.5**	**8**	**4.0**
Kansas	1	1	2	7	3.5	6	3.0
Maryland	24	6	30	43	1.4	62	2.1
Minnesota	2	0	2	4	2.0	3	1.5
Oklahoma	0	0	0	15	--	9	--
Oregon	2	0	2	9	4.5	6	3.0
Washington	5	0	5	14	2.8	6	1.2
Wisconsin	7	0	7	6	0.9	6	0.9

Source: Sonnenschein, Nath & Rosenthal analysis of NAIC data.
[1]**Note:** These are the number of full-time staff either under contract or employed directly by the state to perform market conduct examinations.

The table shows that Colorado completed more market conduct examinations per examiner (i.e., four) than did any of the peer states that reported data. A reporting anomaly, however, may account for this result. Colorado's performance may be due in part to its use of *part-time* contract examiners whose expenses are paid by charging the entity under examination. Colorado did not report these staff because the NAIC directed them to report only *full-time* staff assigned to perform market contract examinations. As a result, part-time contract staff were not reported, but the work they performed was. This makes Colorado's performance (e.g. number of examinations initiated and completed per examiner) appear stronger than it was.

Adjusting for the part-time contract staff provides a more accurate picture of how Colorado's performance compares with peer states. In the reporting year, for example, Colorado had seven contract examiners available but used no more than five at any one time. According to Division staff, about 5 FTE (half of which were state-funded and half of which were on contract) were used regularly throughout the year. Given this, Colorado initiated and completed closer to 1.8 or 1.6 market conduct examinations per examiner in 1996, not the 4.5 or 4 shown above. We were unable to determine which, if any, of the peer states had an arrangement similar to Colorado's that might also skew performance statistics in the market conduct area.

Perhaps a more simple way to assess Colorado's efforts in this functional area is to look at market coverage. The following table shows the number of market conduct examinations completed in 1996 as a percentage of total admitted insurers.

Percentage of Admitted Insurers Receiving a Market Conduct Examination - 1996

State	Number of Exams Completed	Total Number of Admitted Insurers	Percentage of Insurers Examined
Alabama	0	1,498	0.0%
Arizona	50	2,119	2.4%
Arkansas	0	1,501	0.0%
Colorado	8	1,492	0.5%
Kansas	6	1,506	0.4%
Maryland	62	1,485	4.2%
Minnesota	3	1,432	0.2%
Oklahoma	9	1,592	0.6%
Oregon	6	1,573	0.4%
Washington	6	1,391	0.4%
Wisconsin	6	1,810	0.3%

Source: Sonnenschein, Nath & Rosenthal analysis of NAIC data.

The table shows that Colorado's coverage of its insurance industry in terms of market conduct examinations is fourth highest among its peer states. Only two of the peer states examine over 1 percent of their admitted insurers each year, while seven of the peer states examine less than 0.5 percent.

Thus, depending upon how the data are analyzed, Colorado as compared to its peer states may or may not need to improve its output in the area of market conduct examinations. Recommendation No. 3 in Chapter 2 suggests improvements that should help the Division conduct more examinations within current resources.

Consumer Section

As the following table shows, among its peer states, Colorado has the third highest volume of consumer complaints per insurer and fourth highest number of consumer inquiries per insurer.

Analysis of Consumer Complaints Handled in 1996

State	Number of Insurers	Number of Complaints	Number of Inquiries	Complaints/ Insurer	Inquiries/ Insurer
Alabama	1,498	328	3,804	0.2	2.5
Arizona	2,119	7,076	97,215	3.3	45.9
Arkansas	1,501	3,552	3,181	2.4	2.1
Colorado	1,492	7,626	55,077	5.1	36.9
Kansas	1,506	6,673	1,354	4.4	0.9
Maryland	1,485	19,172	N/A	12.9	N/A
Minnesota	1,432	4,543	38,363	3.2	26.8
Oklahoma	1,592	6,371	61,051	4.0	38.3
Oregon	1,573	4,803	32,836	3.1	20.9
Washington	1,391	8,620	124,545	6.2	89.5
Wisconsin	1,810	9,135	44,046	5.0	24.3

Source: Sonnenschein, Nath & Rosenthal analysis of NAIC data.

High complaint volume may be the result of several factors including weak enforcement, the relative outspokenness of the populace, data collection methods, differences in laws (e.g., whether the state has a protest law like Colorado does), and the relative ease by which a complaint can be registered. Colorado's high volume of complaints may be, at least in part, the result of the last factor. The Division has several avenues for lodging a complaint (including through its Web site) and does a good job of publicizing these processes. Arizona and Washington **S** which also have a relatively high volume of complaints **S** are also very active in ensuring that consumers have easy access to complaint processes.

In addition, of the states shown above, only Colorado and Maryland have protest laws. Contacts stemming from a protest law are counted as complaints for the purposes of this comparison, and this may drive up numbers (e.g., as the previous table indicates, Colorado and Maryland are third and first, respectively, in the number of complaints per insurer). Overall, given the differences noted, the data above would indicate that consumers are utilizing the complaint mechanism within Colorado with a frequency similar to consumers in other states. In Chapter 2 we make a recommendation (Recommendation No. 5) that should help the Division prioritize the complaints it receives.

Financial Analysis and Examination Section

As demonstrated in the following table, the Division completed 11 financial examinations in 1996. Among the peer states reporting data, Colorado was among the least active in this area. This is due in part to Colorado's five-year statutory cycle for completing financial examinations of domestic insurers, as opposed to the three-year cycles found in Maryland, Kansas, and Arizona.

Percentage of Admitted Domestic Insurers[1] Receiving a Financial Examination – 1996

State	Number of Exams Completed	Number of Domestic Insurers	Percentage of Insurers Examined
Alabama	0	96	0.0%
Arizona	101	555	18.2%
Arkansas	0	82	0.0%
Colorado	11	93	11.8%
Kansas	14	54	25.9%
Maryland	33	105	31.4%
Minnesota	21	213	9.9%
Oklahoma	0	123	0.0%
Oregon	14	110	12.7%
Washington	13	81	16.0%
Wisconsin	44	350	12.6%

Source: Sonnenschein, Nath & Rosenthal analysis of NAIC data.

[1]Note: Although they are generally empowered to conduct financial examinations of all companies, states focus resources on examining domestic insurers.

Colorado's 11 examinations were completed using 16 FTE, which means that each examiner completed less than one (i.e., 0.7) examination during that year. Colorado's peer states reported completing closer to one full examination per examiner during the same time period. This difference may be due to staff vacancies that Colorado experienced in 1996 (i.e., the Section had two vacancies that year), but it could also indicate the need for quicker turnaround time on financial examinations and/or increased efficiencies in this area. Chapter 2 contains a recommendation (Recommendation No. 2) aimed at refining and automating the Division's current methods for prioritizing financial examinations. Implementing this recommendation should streamline and otherwise improve the Division's financial examination process.

Summary of Observations

None of the data we derived from the peer state comparisons clearly show that there are major problems in the way that Colorado conducts its enforcement-related activities. The enforcement process is complicated and regulators have many options available to them in determining what remedy should be sought to address a dispute or violation. Further, the regulatory climate varies from state to state, with some being more focused on imposing monetary sanctions and others being aimed at maintaining consumer satisfaction and a cooperative, problem-solving relationship with regulated entities. Finally, the variability in insurance laws among states **S** even those states that are comparable in many aspects **S** makes it difficult to make sweeping conclusions about the adequacy of a state's enforcement record on the basis of data comparisons alone.

It may be helpful, however, for the Division to periodically (e.g., once a year) review and analyze data such as those presented in the NAIC's *Insurance Department Resources Report* or similar publications. Such a review could assess where the Division stands in comparison with other states in terms of enforcement activity levels and could subsequently be used to identify areas where resources need to be adjusted. Although the regulatory and industry circumstances present in other states will not match Colorado's environment exactly, a periodic comparative analysis can provide ideas for improvements that managers and policy makers may not have identified otherwise.

Another avenue for the Division to explore when establishing benchmarks and operational goals for its enforcement activities is looking at the enforcement approaches used in states deemed to be strong in this area. For example, California and Illinois are considered to be innovators in the area of market conduct examinations because they use more efficient, targeted examination approaches. Activity levels in states with strong enforcement records could be used as a starting point for developing goals and objectives for Colorado's enforcement program, as long as the Division accounts for differences in the number of regulated entities, resource levels, and other variables.

Recommendation No. 1:

The Division of Insurance should periodically assess how its enforcement-related functions and activities (e.g., financial and market conduct examinations, complaint handling functions, and other activities like investigations) compare with industry standards and best practices. Data derived from this analysis should be used as a starting point for developing goals and objectives for the Division's enforcement program. Data that could be used to determine whether the Division's enforcement activity is adequate may include peer state comparisons, NAIC standards, best practices data, and other information as deemed appropriate.

Division of Insurance Response:

Agree. Although the Division has always participated in the NAIC annual insurance department resources survey, we will more actively use the survey enforcement data on an annual basis to assess differences in enforcement-related functions. Due to the survey's limitations, it will be critical to go beyond the data, however, and learn more directly about other states' practices. One approach might be having Colorado participate in the NAIC enforcement-related committees (particularly in the market conduct area) that are conducted at the quarterly meetings. It should also be recognized that resources do vary considerably even across seemingly similar jurisdictions. As an example, four of the ten peer states have FTE far in excess of Colorado's 95 FTE (e.g., Maryland-240, Washington-155, Wisconsin-141, Kansas-164), which would naturally dramatically impact the resources placed on regulatory functions. Nevertheless, we agree that cross-state comparisons provide important operational insights.

Enforcement Activities

Chapter 2

Overview

The Financial Analysis and Examination, Market Conduct, Consumer, and Investigations Sections perform the bulk of the Division's enforcement activities. As such, we reviewed the following issues as they pertained to these organizational units:

- Adequacy and appropriateness of the procedures used to initiate and conduct enforcement activities.

- Usefulness of the systems for prioritizing examinations and investigations of entities that have been identified as problematic.

- Responsiveness/timeliness of enforcement actions (e.g., turnaround time on market conduct examinations).

- Adequacy and appropriateness of the sanctions available and in use to discipline violators.

Whenever possible, we used accepted industry standards (e.g., NAIC guidelines) as our gauge of whether a procedure or process was adequate.

Our review showed that some improvements were needed in each of the sections that has enforcement-related responsibilities. Our specific findings are discussed in the remainder of this chapter.

We also observed that the Division has recently made two key improvements in its enforcement-related processes. First, in January 1998 the Division issued a policy (i.e., Bulletin No. 1-98 entitled "Enforcement Guidelines for Fines and Penalties") that established a standardized methodology for assessing penalties and sanctioning entities found to be in violation of Colorado insurance laws or regulations. Prior to 1998 the assessment of fines or sanctions resulting from an enforcement-related activity (e.g., a market conduct examination or a complaint investigation) was a subjective process. The purpose of Bulletin 1-98 was to promote consistency, predictability, and fairness in the enforcement process. Prior to issuing these formalized guidelines, it was possible for different entities, under similar circumstances, to receive different fines and penalties. We believe that these guidelines create an adequate framework for the assessment of sanctions against entities found to be in violation of a law and/or regulation. Further, the range and scope of penalties set forth in the guidelines are consistent with the actions that other states take, although few states have guidelines available in a concise format.

Second, in November 1999 the Division plans to complete conversion to a new computerized regulatory information system (i.e., COSMOS). This integrated database system will enable the Division to input, maintain, track, and utilize information about its enforcement activities and regulatory efforts. The system also contains various licensure data. According to Division staff, COSMOS will be a vast improvement over the Division's former processes for managing regulatory and enforcement data (i.e., some processes were manual and others were managed using a mainframe system called FOCUS, which had several problems).

The Division Must Perform a Financial Examination of Each Domestic Insurer Once Every Five Years

The Division is mandated to perform financial examinations of 71 of Colorado's 93 domestic insurers once every five years (Section 10-1-203, C.R.S.). Twenty-two domestic insurers (i.e., 13 captive insurance companies and 9 prepaid dental companies) are not subject to this examination requirement. The purpose of these examinations is to ensure that an insurance company is solvent and, therefore, able to pay claims and transact business with its customers in a normal manner. Companies are selected for financial examination based on statutory requirements and the following factors:

- Companies identified as problematic by the NAIC early-warning system. This system (i.e., a series of tests applied to published financial statements) assists state regulators in compiling a watch list of companies that require closer surveillance.

- Companies identified by Division staff as a higher priority for review. Analyses of several factors (e.g., indications of problems in a company's overall financial condition, results from prior examinations) may result in a company being identified as a Division priority.

The Division's financial examination process was first accredited by the NAIC's Financial Regulation Standards Accreditation Program in 1992. The Division's process was subsequently reevaluated and reaccredited in 1997.

During our performance audit we reviewed four financial examinations that were initiated and completed in 1997 and found that the reviews were both conducted pursuant to the established procedures (which meet NAIC accreditation standards) and supported by appropriate documentation. Further, we reviewed the Division's examination schedule and found that in 1997 the Division completed 19 financial examinations. This level of activity should be sufficient to ensure that the Division will meet the examination schedule set forth in statute (i.e., review of each domestic insurer once every five years).

Examinations Should Be Prioritized Using Automated Methods

As stated previously, financial examinations are prioritized based upon the NAIC's early-warning system and determinations made by Division staff. Two problems are inherent in this process. First, the evaluation process is a manual one and must be conducted each year prior to setting the examination schedule. Because the process is not automated, it is time-consuming and may be prone to errors and oversights. Second, Colorado-specific financial issues play a minor role in this assessment. Some problems that cannot be identified by the NAIC early-warning system may also be important in terms of assessing the financial strength of an insurer doing business in Colorado. For example, the NAIC early-warning system does not have information on delayed claims payments that have been identified through the Division's complaint handling processes. Delayed claims payments are often one of the first signs that a company is in financial trouble. By not systematically monitoring this type of information, the Division may be overlooking important clues that a company is in financial difficulty.

To address these issues, the Division could create an automated process, ideally through COSMOS (the Division's new computer system for maintaining regulatory information), wherein domestic companies that show symptoms of being in troubled financial condition are flagged for examination (i.e., added to the Division's watch list). Triggers might include delayed payments on claims, reduced premium volume, and/or inordinately high rate increases.

Recommendation No. 2:

The Division of Insurance should develop and implement a Colorado-specific early-warning system and use this information to augment processes already in place to prioritize financial examinations. To the extent possible, the Division should use automated methods to comply with this recommendation.

Division of Insurance Response:

Agree. The Division will be completing its development of a comprehensive, integrated database bringing together all of the informational needs of our regulatory system. This project, first initiated in late 1997, will be completed 12/31/99 and the Division will automate Colorado-specific information to create a more comprehensive early-warning system. This system will incorporate such information as delayed payment information to consumers and providers, changes in the number of consumer complaints, etc. In the health care arena, these data can prove critical to the financial stability of health insurers. It should be noted that, although informational systems are not yet fully automated, Colorado has maintained a high level of financial scrutiny over its 93 domestic insurers and our State has been relatively free of the insurer insolvencies that have plagued other insurance jurisdictions or other types of financial service sectors.

Companies Are Selected for Market Conduct Examinations on the Basis of Several Factors

The primary function of the Market Conduct Section is to perform on-site compliance examinations and desk audits of insurance companies admitted to do business in Colorado. The Section has written procedures that establish criteria for selecting a company for examination. Criteria include:

- Complaint ratio (i.e., ratio of complaints to policies in force, by insurer).
- Market share (i.e., percentage of Colorado's total insurance market that a company represents by line of business such as property and casualty policies).
- Recent changes in statutes or regulations that could impact a particular line of business.
- Company-specific problems identified by other Division units.

- Marketwide issues (i.e., underwriting practices of health insurers regarding preexisting conditions).

Additional factors that are considered when companies are selected for market conduct examinations include the results of financial statement analyses and examination reports from other states. The exact order in which a company will be examined is based upon the urgency/severity of problems and regulatory concerns that may be present at the company, the geographic location of the company (which is considered to ensure efficient scheduling of examination staff), and the availability of the company (i.e., whether the company will be under examination by another state). We found that staff adhere to established prioritization guidelines.

Once a company is identified for an on-site examination, the company is informed and then examiners are sent to the company where they review files and documents related to the company's business and market conduct practices. Generally, an on-site review will focus on one line of business (e.g., life and health insurance products) at a particular company. Findings from the examination are written in a report and once a company's responses to the findings are received, Division staff (including the Consumer Affairs Compliance Director) determine whether an enforcement action is required (e.g., fines, penalties, stipulations, resolutions, and/or consent orders).

The other primary examination tool used by the Market Conduct Section is the desk audit, wherein the Division directs a company to review all records regarding consumers or policies that may have been affected by certain business practices over a specific period of time. Other Division units are the main source of suggestions for desk audits. For example, the Consumer Section may receive a complaint or complaints that may indicate that an entity is engaging in a companywide practice that is in violation of law or regulation. The desk audit process is much less resource-intensive than the on-site market conduct examination process.

The procedures utilized by the examination staff in the Market Conduct Section are both current and adequate to ensure that examinations are handled in compliance with Colorado's statutory examination obligations and Division objectives. The procedures are similar to those used by other states that conduct these types of examinations and are based upon the most recently revised NAIC procedures. On the basis of our review of all the market conduct examinations that were conducted in 1997, the Division's procedures were adhered to uniformly.

Turnaround Time for Market Conduct Examinations Has Improved

We found that in 1997 the average market conduct examination ran 211 calendar days from start to finish. This average time frame, which was excessive, has been reduced in 1998. Preliminary data show that the average turnaround time for a market conduct examination has been reduced to about 120 days, which compares favorably with other states. Making the market conduct examination process more timely is important to consumers, and therefore, we urge the Division to pursue continued improvements in this area.

The Division Should Consider Use of Short-Term, Issue-Specific Market Conduct Examinations

As discussed previously, the Market Conduct Section's main enforcement tools consist of either the more extensive, on-site examination approach or the desk audit approach. Both enforcement methods have their drawbacks. For example, on-site examinations are both resource- and time-consuming. This approach also tends to focus on a single line of business at a single company (e.g., one insurer's property and casualty insurance products) rather than on a practice or issue that may be of concern across entities. Further, the desk audit examination approach provides information on a narrow scope of inquiry at a particular entity and relies upon documentation that is company-prepared.

Because of the shortcomings of these two approaches, we believe that the Division should consider adding an intermediate level of examination (i.e., a short-term, issue-specific market conduct examination) to its enforcement activities. This type of examination would be less resource- and time-consuming than a full on-site examination and more thorough than a desk audit. Further, using this type of approach more frequently would also allow the Division to identify, examine, and resolve specific, high-priority market conduct and enforcement issues across a greater number of regulated entities. We estimate that if each examiner completed an average of three issue-specific exams annually, the Division would be able to provide more constant and close monitoring of approximately 30 percent of Colorado's domestic insurers.

Issues for these examinations could be identified through consumer complaints, Division staff, or other means. Once a particular issue or problem area is identified, the Division could select and prioritize companies to review on the basis of market share or other pertinent criteria. After this process, examiners would perform a short (perhaps two-week) on-site examination of the policies and procedures relevant to the target issue(s) only. The examiner then would report on his or her findings and enforcement recommendations using the process that is already in place for other types of market conduct examinations.

Recommendation No. 3:

The Division of Insurance should use short-term, issue-specific market conduct examinations to increase its enforcement coverage and to make better use of existing resources.

Division of Insurance Response:

Agree. The market conduct examination function has been identified by many parties, including the State Auditor, as one of the most important activities conducted by the Division of Insurance. Given the complexity of insurance products, the public is highly interested in learning the outcomes of these consumer practices audits. These audits frequently result in dollars returned directly to consumers. This emphasis on market conduct examinations was reinforced by the General Assembly's decision to place more resources in this program in 1997. Initially, the Division believed it was important to conduct these exams on a broader scope so that assessments could be made of general industry compliance. This proved highly valuable as many of the audits revealed significant deficiencies in insurer operations in many areas. As the Division conducts follow-up exams to these audits, they can now be conducted on a more narrow focus related to the prior audit findings. Audits are also being initiated in several areas that are issue-specific such as controlled business arrangements in the title insurance industry, the calculation of experience modification factors and statistical data reporting by workers' compensation insurers, the progress of insurers in gaining Year 2000 compliance, and the repricing of medical claims by auto insurers under personal injury protection (PIP).

The Division Handles Thousands of Complaints Annually

The Division defines a complaint as any written correspondence (including electronic mail) expressing a grievance against an insurer. Complaints presented via telephone, while dealt with immediately by staff in the Consumer Section, are also requested in written form. The following table shows the resolution of the complaint cases that were closed during Calendar Year 1997.

Analysis of Complaints Received by the Division
Cases Closed in Calendar Year 1997

Type of Insurer	Total Complaints	Complaints Resolved in Consumer's Favor	Complaints Where the Company's Action Was Upheld	Information-Only Inquiries
Life, Accident, or Health Insurance	2,851	1,126	832	893
Property and Casualty (Non-Protest)	2,236	766	958	512
Property and Casualty (Protest)	2,541	794	1,747	0
TOTAL	**7,628**	**2,686**	**3,537**	**1,405**

Source: Division of Insurance.

On the basis of these data, each staff analyst handles roughly 400 complaints per year. In 1997 the average turnaround time for handling a complaint was 52 days for property and casualty insurance issues and 64 days for life and health insurance issues.

Some Procedures Are Outdated

Two procedural guidelines were utilized by the Consumer Section in 1997. These were the Division's 1989 Guideline Manual (this manual is used divisionwide) and a procedures manual specifically tailored to the Consumer Section. There are also separate procedures manuals for the Property and Casualty Unit and the Life, Accident, and Health Unit.

To determine whether established procedures were followed by the Consumer Section, we reviewed a randomly chosen sample of 49 protest and 92 non-protest complaint cases closed during 1997. We found no material deviations from established procedures in any of the 141 cases we reviewed except for a few instances where a consumer inquiry/complaint was not acknowledged in writing within the five-calendar-day deadline established by policy. Further, the procedures contained in the manuals specifically tailored to individual organizational units appear to be adequate insofar as they apply. However, we did note that the Guideline Manual has not been updated since January 1989.

We also reviewed a randomly chosen sample of 36 cases that were closed by the Investigations Section in 1997 to determine whether established procedures were being followed. However, we could not determine whether established procedures were followed in these cases, because the Division was in the process of changing its methods for handling investigations. Specifically, in 1997 the Division hired an outside consultant (i.e., Doolittle & Company) to perform a process and procedure review of the Consumer and Investigations Sections. As a result of this review, revised procedures, which were later supplemented with more detail from Division staff, were recommended for the Investigations Section. The proposed procedures were submitted to management for its review but have yet to be formally approved.

The proposed procedures for the Investigations Section do appear to be adequate to ensure proper handling of investigations. Further, prior to Doolittle's review, written procedures for prioritizing the work performed in the Investigations Section did not exist. The section supervisor reviewed each new case, determined which was most urgent, and assigned the priority. The prioritization measures that were recommended by the Doolittle report require staff to evaluate and assign priority to cases on the basis of 12 factors (e.g., number of victims, whether fraudulent activity is involved, whether violations are ongoing). We observed that the new prioritization measures are being followed, are adequate to ensure appropriate workflow, and are appropriate to ensure resources are expended where the most risk to Colorado consumers and/or the insurance marketplace exists.

We urge the Division both to update its general procedures manual (Guideline Manual) and to formally adopt the proposed procedural revisions for the Investigations Section to ensure efficient and effective handling of complaints and other Division business.

An Objective System for Prioritizing Complaints Is Needed

Currently complaints received by the Division are not prioritized on the basis of any objective, issue-based criteria. The only written procedure that addresses the prioritization of work in the Consumer Section is found in the Division's 1989 Guideline Manual, which is a general procedures manual used by staff throughout the Division. The procedure found in the Guideline Manual addresses the handling of "special complaints" (i.e., a complaint referred from the Governor's Office, Division or Department management, members of the General Assembly, or members of Colorado's congressional delegation, among others) and implies that complaints received from any of these sources should be handled more promptly than complaints originating elsewhere. This procedure, which assigns priority on the basis of the status of the individual generating the complaint, does not take into account the urgency or severity of the complaint itself. Standard complaints (i.e., those generated from persons other than those listed above) are prioritized at staff discretion.

To address this issue, the Consumer Section should develop a decision matrix to assist staff in prioritizing all complaints. Ideally, a prioritization system should be automated (e.g., priority could be assigned when data about a complaint are entered into COSMOS). Factors that should be considered in developing an objective prioritization system should include potential harm that may be posed to the complainant, the insurance marketplace, or the public at large. The Division should also consider the likelihood that criminal activity is present when determining the priority of an individual complaint. Obviously, a priority system should also ensure that all complaints are handled in the most expedient manner possible.

Recommendation No. 4:

The Division of Insurance should update its Guideline Manual and formally adopt the proposed procedures revisions for the Investigations Section.

Division of Insurance Response:

Agree. The guidelines developed as a result of a 1997 review have been placed in operation and have demonstrated significant improvement in the quality of case development. These investigational guidelines have also now been formally adopted by management. The Division will now proceed to update its more generalized divisionwide procedures manual pursuant to the audit recommendation.

Recommendation No. 5:

The Division of Insurance should develop a comprehensive prioritization system for all complaints received and handled by Division staff.

Division of Insurance Response:

Agree. Although there are clearly informal efforts to develop complaint prioritization based on factors such as life threatening conditions, suspected fraud, house fire, immediate loss of medical provider, etc., these criteria need formal development as part of the new automated integrated database. The Division incorporates, as part of its consumer education efforts, a strong emphasis for the public to actively use its consumer services which results in thousands of letters, phone calls, and complaints. An improved complaint prioritization system will be useful to many Division employees and will improve resource utilization.

No Individual Workload Measures Exist for Enforcement Staff

We noted that although some organizational units establish overall benchmarks and performance targets, there are no established individual performance standards for staff who conduct enforcement activities in the Market Conduct, Consumer, and Investigations Sections. Establishing standards would allow management and staff to review and compare individual workload and performance and would assist the Division in implementing Colorado Peak Performance (scheduled to be in place during Fiscal Year 2000).

The factors that should be considered in establishing performance standards include:

- **Market Conduct Section:** Individual performance in this unit could be gauged by establishing targets for the number of each type of examination (i.e., on-site, desk, or issue-specific reviews) that an examiner should complete each year and examination turnaround time.

- **Consumer Section:** Performance in this unit could be measured using benchmarks that establish the number of calls that staff should handle in a particular time period, the number of cases an analyst should open and close annually, and standard turnaround times for responding to complaints/inquiries and for case closure.

- **Investigations Section:** Benchmarks in this unit could be developed by using a mixture of the performance standards established for the units mentioned previously.

Whenever possible, the Division should use NAIC guidelines or Insurance Regulatory Examiners Society standards to establish appropriate performance indicators.

Recommendation No. 6:

The Division of Insurance should develop objective individual workload measures for all staff with enforcement-related functions in the Market Conduct, Consumer, and Investigations Sections.

Division of Insurance Response:

Agree. The Division has placed a high priority in its annual strategic plan to develop objective individual workload measures. Not only is this an integral component to the success of the enforcement program, but it is also a requirement for DORA's implementation of the statewide Peak Performance project. Initial work has been completed in drafting performance standards for commonly used classes in DORA but all of these will need to be supplemented with specific individual measures. Not only will quantitative measures such as those outlined in this audit (e.g., number of calls, number of completed exams, number of cases opened and closed) be used, but efforts must be made to develop qualitative measures that result in effective regulation.

Interaction With the Department of Law

Chapter 3

Overview

The Department of Law, or the Attorney General's Office, employs the staff who provide legal services for most Colorado state agencies, including the Division of Insurance. Funding to pay for the cost of legal services, however, is allocated to the Division, which then pays the Department of Law for services as they are rendered. This arrangement for providing legal services is known as the "Oregon Plan" and has been in existence in state government since 1973. In Fiscal Years 1997 and 1998 the Division paid about $210,000 and $463,000, respectively, to the Department of Law for legal services.

Most of the Division's legal matters are handled by the Department of Law's Regulatory Law Section or another unit specifically assigned to investigate cases of suspected insurance fraud. The Department of Law reports that the Division's attorneys are allocated in the manner shown in the following table. Staff may be reallocated, however, if workload dictates a shift.

Allocation of Department of Law Attorneys Dedicated to Division Activities	
Function	**FTE**
General Duties/Counsel	1.0
Investigations	1.0
Legislation/Regulations	0.5
Financial	1.0
Consumer Complaints	0.5
Market Conduct	1.0
Insurance Fraud	2.5
TOTAL	**7.5**
Source: Department of Law and Joint Budget Committee Appropriations Reports.	

In 1997 the Department of Law opened 16 and closed 35 litigation matters and opened 22 and closed 57 nonlitigation matters for the Division, using two attorneys for the first half of the year, and three thereafter. In the first half of 1998, 22 litigation matters were opened and 7 were closed as well as 48 non-litigation matters being opened and 9 closed.

The Department of Law has created internal efficiency standards regarding legal opinion turnaround and file review, which appear to be both reasonable and enforced. For litigation matters, the rules of criminal and civil procedure control document production and, in turn, production deadlines. The Department of Law also maintains specific efficiency standards in representing the Division in non-litigation matters.

The Division also has an attorney position **S** the Consumer Affairs Compliance Director **S** that serves as liaison between the Department of Law and the Division. This position was created in 1997 and, among other duties, is responsible for drafting consent orders, reviewing proposed sanctions and penalties, coordinating activities with the Department of Law, and consulting on all internal enforcement activity.

The Disciplinary Process Is Cumbersome and Resource-Intensive

The Division's enforcement authority covers issues that range from simple and routine (e.g., imposition of penalties for late filings) to complex and unique (e.g., development of remedies to problems discovered in an extensive market conduct examination). Because of its large scope of authority, the Division's processes for disciplining entities found to be in violation of a law or regulation must cover a number of situations and circumstances. The result is a process that is sometimes overly time-consuming, and resource-intensive. Further, the process requires, in almost all instances, coordination between multiple units and individuals within the Division and between the Division and the Department of Law. This makes the process even more complicated.

Although the broad nature of the Division's enforcement authority will make the disciplinary process complex, we did identify some aspects of the process that could be standardized and/or made routine. We believe that standardization could improve the disciplinary process by reducing the time needed to impose certain types of actions and, consequently, reducing the resources needed to conduct the Division's enforcement functions. Another benefit from standardization is that there would be greater assurance that entities with similar infractions receive similar treatment. Changes should be pursued in the following areas:

- **Routine Consent Orders:** In many cases the violations found by the Division's Market Conduct, Consumer, and Investigations Sections are routine or recurring (e.g., late filing of required documents such as annual statements or an agent with an expired license selling insurance). To address these types of situations, the Division should work with the Department of Law to develop standardized consent orders (i.e., agreements between the entity being disciplined and the Division about what action is needed to address the violation or violations). A set of standardized orders would serve to reduce the administrative cost of enforcement actions by allowing staff to proceed in certain cases without incurring various procedural hurdles (e.g., contacting the Department of Law, obtaining required approvals and reviews). Standardization would also lead to more uniform imposition of penalties and sanctions.

- **Complex Orders:** Current procedures require the Consumer Affairs Compliance Director to draft all complex consent orders. The Department of Law is not necessarily involved in this process, however, unless it was already involved in the case for some reason (e.g., participating in an investigation or settlement). We recommend that procedures be put in place to ensure that the Department of Law reviews all proposed complex orders prior to their review and approval by the Commissioner. This procedure would serve a twofold purpose: as a quality control device (e.g., ensuring that the correct legal analysis was employed in the case and that the order is defensible by the State) and as an early-warning system for potential litigation. This may, in turn, reduce future litigation costs by identifying potential problems prior to the issuance of a particular order.

- **Alternative Discipline System:** A number of states have implemented an alternative system for resolving regulatory disputes. Such a system allows, for example, an entity to stipulate to a violation and pay a fine/restitution/other penalty, at its election, thus avoiding a hearing and/or other aspects of the traditional enforcement process. This alternative discipline system enables the timely resolution of smaller-scale violations while using fewer internal resources. Under an alternative disciplinary system, Division staff would follow a series of concrete steps that first communicate the nature of a violation with the regulated entity and then provide options for the entity to take in resolving the issue. Such a system could also employ standardized orders (discussed previously) to ensure that enforcement actions are uniform and equitable. A common alternative discipline system that is used by a number of states calls for a five-step, graduated enforcement process as follows:

- A warning letter is sent to the entity (e.g., insurance company or agent).
- A meeting with the party is held to discuss the alleged violation.
- A targeted examination is conducted to ensure additional and/or related violations have not occurred.
- A stipulated settlement is arranged.
- An order to show cause is issued.

Recommendation No. 7:

The Division of Insurance should restructure its disciplinary processes to maximize efficiency. This should include working with the Department of Law in developing a series of standardized orders that address usual and customary enforcement actions; establishing standard procedures that ensure the Department of Law is a participant in the drafting and final review of all complex consent orders; and developing an alternative discipline system.

Division of Insurance Response:

Agree. Coordination efforts with the Department of Law to be more involved in complex cases have already begun. Statutory time frames for completing insurance examinations are very tight so the successful use of legal services will be dependent upon their timely delivery.

Department of Law Response:

Agree.

Communication Between the Division and the Department of Law Can Be Improved

Once a case is opened with Department of Law, Division staff are kept informed of the case's status through the use of status memos and information exchanges that occur at monthly legal services meetings held by Department and Division management staff. Further, cases are prioritized by Department of Law staff on the basis of input received from Division staff who attend these monthly meetings.

Our review showed that the processes used to keep Division apprised of the status of cases could be improved in two ways. First, line attorneys, along with management staff from the Department of Law, should be allowed to participate in the case prioritization process. Heightening the level of line attorney participation might be helpful as they are the persons in the best position to advise the Division of likely case outcomes, propose case development strategies, and inform staff about litigation options. All of this information is helpful in determining which cases should receive the most attention. In addition, we believe that use of the Department of Law's written case status reports should be increased. Increased use of the status reports would allow the monthly legal services meetings to be used for the development of strategy and objectives and not to update staff on the status of various cases.

We also found that clear communication of Division requests for advisory opinions, litigation, file review and comments and desired outcome is imperative to ensure attorney time is used efficiently. Although the forms that Division personnel use to request legal services from the Department of Law have been recently updated to include information such as desired outcomes, additional training of Division staff regarding this subject would be helpful. In addition, staff at the Department of Law mentioned that the Division's request forms could be improved by adding a place for Division staff to indicate the initial priority of each case. The Department of Law's resources can be much more efficiently used if Division objectives are clear from the start of the case.

Recommendation No. 8:

The Division of Insurance, working with the Department of Law, should ensure that Division objectives and priorities are clearly determined and communicated. Methods to improve communication may include heightening the level of participation in monthly status meetings by line attorneys, increasing and improving use of written case status reports, and providing training to Division staff.

Division of Insurance Response:

Agree. A key document for monitoring the Division's objectives and priorities is the case status report prepared by the Department of Law. The Division has requested that this document be prepared on a regular monthly cycle and that it fully annotate the work conducted during the month on the case, and detail any obstacles encountered that may hinder the completion of the case. Once this document is fully prepared by the Department of Law and linked to case expenditures, it is expected that cases can be more effectively prioritized. Improving workload-tracking systems can provide better legal services cost monitoring and projecting of attorney staffing levels.

Department of Law Response:

Agree.

Case Preparation Needs Improvement

In 1997 the average length of time that an investigation was open was 178 days. This time frame was due in part to delays in communication between investigators and the Department of Law. Delays such as this could be reduced if communication between the Division's functional units (especially the Investigations Section) and the Department of Law was improved. At present, staff in the Investigations Section handle their own case files and perform various case preparation and development tasks. This includes managing the investigation process once it is brought forth as a legal issue by other Division units up until the time the case is referred to the Department of Law for further action.

Communication problems between the Division's Investigations Section, the Department of Law, and other Division units can create substantial delays in the resolution of investigations. Upon sending the case to the Department of Law, Division staff prepare a "Request for Legal Services" document that contains a brief summary of the issues in the case. This request form, which is sent to the Department of Law along with some file contents, does not appear to provide a sufficient basis for commencing activities at the Department. As a result, Department of Law staff frequently must contact the Division for additional back-up materials, witnesses' names and addresses, or other facts needed to proceed with a case. Adding a field in the COSMOS system to flag case file requirements or requiring the Consumer Affairs Compliance Director to review case files prior to their being sent to the Department of Law might alleviate some problems. The Consumer Affairs Compliance Director could also work with staff at the Department of Law to prepare a case file checklist that could be used by Division staff before a case file is sent to the Department.

The Department of Law should have direct access to the Division staff working on cases, including the Consumer Affairs Compliance Director, investigators, complaint analysts, and market conduct examiners. Division staff and Department of Law attorneys can then hold meetings, directly communicate, and share information expediently in order to address issues and resolve questions.

Additional Training Could Help Ensure Cases Are Adequately Prepared

Additional Division staff training on investigations issues is also needed to ensure that cases are adequately prepared and documented. Department of Law could provide training for Division staff on case requirements, legally imposed deadlines, filing time frames, or related issues. Division staff could also avail themselves of the investigative training available through the NAIC, the National Insurance Crime Bureau, the Federal Bureau of Investigation, and other law enforcement agencies in order to enhance their case development, documentation, and preparation skills.

Recommendation No. 9:

The Division of Insurance, working with the Department of Law, should ensure case files are referred to the Department with sufficient information. This may include developing a case review process at the Division or other methods that will ensure cases are adequately prepared and documented prior to being sent to the Department of Law.

Division of Insurance Response:

Agree. The Division has completed work on these processes to ensure case files are referred to the Department of Law with sufficient information. Meetings have been ongoing in 1998 with the Department of Law to encourage greater cross-discussion of the cases in development. Better communication ensures that preparation weakness can be identified at an earlier stage and rectified.

Department of Law Response:

Agree.

Recommendation No. 10:

The Division of Insurance should ensure that staff involved with investigations-related functions are adequately trained in case development, documentation, and preparation skills.

Division of Insurance Response:

Agree. Investigators were sent to training in 1998 sponsored by the Clearinghouse on Licensure, Enforcement, and Regulation (CLEAR) and the Assistant Attorney Generals have conducted training for Division employees on investigational techniques. The Division will continue to identify training opportunities within the resources available. Furthermore, training objectives will be incorporated into their performance plans.

Department of Law Response:

Agree.

External Communications

Chapter 4

Overview

The Division communicates with the insurance industry, consumers, and others in four primary ways – its Web site, newsletter (The Regulator), periodic bulletins, and by responding to specific inquiries and requests for documents. In addition to these methods, the Division maintains a toll-free (800) number for consumers to use whenever they have a question or complaint and provides speakers for business and consumer groups when requested.

External Communications Can Assist in Enforcement

External communications can be an important enforcement tool in that they provide a means for the Division to educate consumers, the insurance industry, and others about insurance laws and regulations. External communications also provide a medium to exchange information about the Division's enforcement role and a forum to solicit complaints. Accordingly, we reviewed the effectiveness of the Division's external communications both in general and in terms of their relationship to ongoing enforcement activities. Our review included a survey of seven multiline insurers, four consumer groups, and four agent associations. Overall, the individuals we surveyed provided mostly positive comments about the Division's communication efforts. However, some of the surveyed parties also mentioned ways that the Division could enhance or improve its methods for communicating with outside parties. Suggestions included:

- Increase publicity for the Division's 800 number.

- Communicate with consumers using more "low-tech" methods as well as via the Internet. "Low-tech" methods include disseminating pamphlets, brochures, and news releases.

- Provide insurers with more information about the methods used to calculate fines and penalties.

- Issue market conduct examination reports in a more timely fashion. The Division is using its Web site to disseminate these reports. This appears to be an effective medium for issuing this type of information, as long as it is done in a timely manner.

- Review Division correspondence for consistency and other issues such as tone.

- Provide agents with more information on company enforcement actions and the Division's "watch list."

- Print the newsletter (*The Regulator*) more regularly. The distribution cycle for the newsletter is generally quarterly, but the audit team noted that the position that was responsible for writing and distributing it was vacant in 1997. The position has now been filled and the newsletter is once again scheduled for regular circulation.

- Continue making speakers available to organizations.

- Continue the Web site. Feedback from agents, agent associations, and insurers regarding the Web site was very positive.

These comments provide a good basis for targeting improvements in the Division's external communication methods. The Division should explore the cost-effectiveness of making these changes and make improvements where it is feasible.

Recommendation No. 11:

The Division of Insurance should pursue various improvements in its methods for communicating with consumers, the insurance industry, and other external parties. Methods may include publishing the newsletter on a more frequent basis, expanding communications in various topical areas, especially those related to the Division's enforcement functions.

Division of Insurance Response:

Agree. The Division strongly believes that consumer and industry education is an essential component of an effective regulatory system. Insurance products continue to increase in complexity making it difficult for consumers to understand their insurance purchases and more difficult for insurers to be compliant with state regulations. With the hiring of a full-time Public Affairs Director in October 1997, the Division has revamped its educational materials including, for the first time, a quarterly publication for industry professionals describing current changes in laws and regulations, recent enforcement actions, key contacts at the Division, companies that have been recently licensed, and major program initiatives. Communication of the “800" number has increased through our brochures, Web site, press releases, and anticipated public service announcements (spring 1999). Our Web site now includes the full text of all financial and market conduct examinations of insurers so that the public can make informed decisions on insurers. Using the recommendations in this report, the Division will continue to expand its communication efforts so that our outreach efforts are even more comprehensive.

Distribution

Copies of this report have been distributed to:

Legislative Audit Committee (12)

Division of Insurance (8)
Department of Regulatory Agencies (2)

Department of Law (1)

Joint Budget Committee (2)

Department of Personnel
d.b.a. General Support Services
Executive Director (2)
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