

Study of Missouri's  
Insurance Market Conduct Examination Program  
with Proposed Recommendations



Submitted by:

Missouri Department of Insurance,  
Financial Institutions  
& Professional Registration

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## Overview of Study

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- I. Scope and Background of Review
- II. Goals of Review
- III. Background of the Market Conduct Examination Section
  - A. Statutory Authority for Market Conduct Examinations
  - B. Organizational Structure of the Market Conduct Section
- IV. Current Process and Procedures
  - A. General Information
  - B. Market Analysis
  - C. Examination Process
  - D. Penalty Assessments
- V. Findings and Recommendations to the General Assembly
- VI. Conclusion

## **I. Scope and Background of Review**

This study of the Market Conduct Examination Section within the Insurance Market Regulation Division of the Department of Insurance, Financial Institutions and Professional Registration (“Department”) includes a review of the following areas: Market Analysis, Examinations, Legal Actions and Administration. The study primarily encompasses data from calendar years 2005 and 2006.

SB 66 (2007) included § 374.208, RSMo, which states:

The director shall study and recommend to the General Assembly changes to avoid unnecessary duplication of market conduct activities and to implement uniform processes and procedures for market analysis and market conduct examinations which will more effectively utilize resources to protect insurance consumers. The study shall be completed and recommendations provided by January 1, 2008.

## **II. Goals of Review**

- Review organizational structure, examination expenditures, examination findings, length of examinations and penalties to evaluate effectiveness and efficiency of program.
- Review modernization efforts nationwide to assist in determining best practices and areas of improvement.
- Review methods used to track, monitor and evaluate current program.
- Summarize findings and provide recommendations for the General Assembly.

## **III. Background of the Market Conduct Examination Section**

Missouri’s insurance market conduct examination program was created in 1972. As a result, the State of Missouri holds the distinction of being home to the longest uninterrupted market conduct examination program in the nation. Most U.S. jurisdictions utilize some form of market conduct process to identify potential concerns and address consumer complaints regarding the placement of insurance within their respective territories. According to a recent NAIC report, only three jurisdictions (Hawaii, Nevada and Puerto Rico) have no staff members devoted to market conduct examination or analysis.

In 1971, The National Association of Insurance Commissioners (“NAIC”) funded a study to review the financial and market conduct surveillance of insurance companies. The NAIC commissioned McKinsey & Company, Inc. to perform the study and produce a report detailing its results and conclusions. Before the early 1970s, state insurance regulators primarily emphasized financial solvency. The McKinsey study recommended establishing a separate and distinct program of market conduct surveillance, including market conduct examinations that would be separate from financial examinations and be administered by different examination personnel. The study also concluded that some states had been struggling with market conduct regulatory problems for many years, but that few states had developed comprehensive, organized oversight systems to respond to these problems.

Since the McKinsey study’s release, individual state insurance departments have implemented the study’s general recommendations in a variety of ways. While the NAIC has sought to bring uniformity and coordination to market conduct examinations, the efficiency and effectiveness of market conduct regulation has not been evaluated on a comprehensive level since the McKinsey review.

#### **A. Statutory Authority for Market Conduct Examinations**

The Missouri General Assembly authorized the Missouri market conduct examination process in 1972 when it enacted § 374.205, RSMo. The law granted broad powers in performing examinations of any entity subject to the regulatory control of the Missouri director of insurance (“Director”).<sup>1</sup> The general investigative powers of the Director were set forth in § 374.190, RSMo, which specifically stated as follows:

The superintendent shall examine and inquire into all violations of the insurance laws of the state, and examine the financial condition, affairs and management of any insurance company incorporated by or doing business in this state, and inquire into and investigate the business of insurance transacted in this state by any insurance agent, broker, agency or insurance company.

In 1992, the Missouri Legislature passed HB 1574 which revised the market conduct authority of the Department under §§ 374.202 - 374.207, RSMo. Section 374.202, RSMo, now states the following:

The purpose of sections 374.202 to 374.207 is to provide an effective and efficient system for examining the activities, operations, financial or market conduct, condition and affairs of all persons transacting the business of insurance in this state and all persons otherwise subject to the jurisdiction of the director. The provisions of sections 374.202 to 374.207 are intended to

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<sup>1</sup> At that time, the Director served as the administrator of the Division of Insurance. Since that time, the division of insurance has become the Department of Insurance, Financial Institutions and Professional Registration.

enable the director to adopt a flexible system of examinations which directs resources as the director may deem appropriate and necessary for the administration of the insurance related laws of this state.

Listed in the table below are statutory references to each aspect of the market conduct examination process.

<b>RSMo.</b>	<b>Reference</b>
354.190	Health Services Corporations
354.465	HMOs
374.110	Examiner duties-assistants-fees
374.190	Investigation of Companies
374.202 - 374.207	Examiner definition, appointment, restrictions, expenses
374.210	False testimony-refusal to furnish information-false entries-penalties
375.445	Company operating fraudulently or in bad faith-charges-hearing-penalties
375.938	Director may investigate companies
375.1009	Director may investigate improper claims practice
376.383	Prompt pay examinations of health insurers
379.343-379.475	Rating Organizations

## **B. Organizational Structure of the Market Conduct Section**

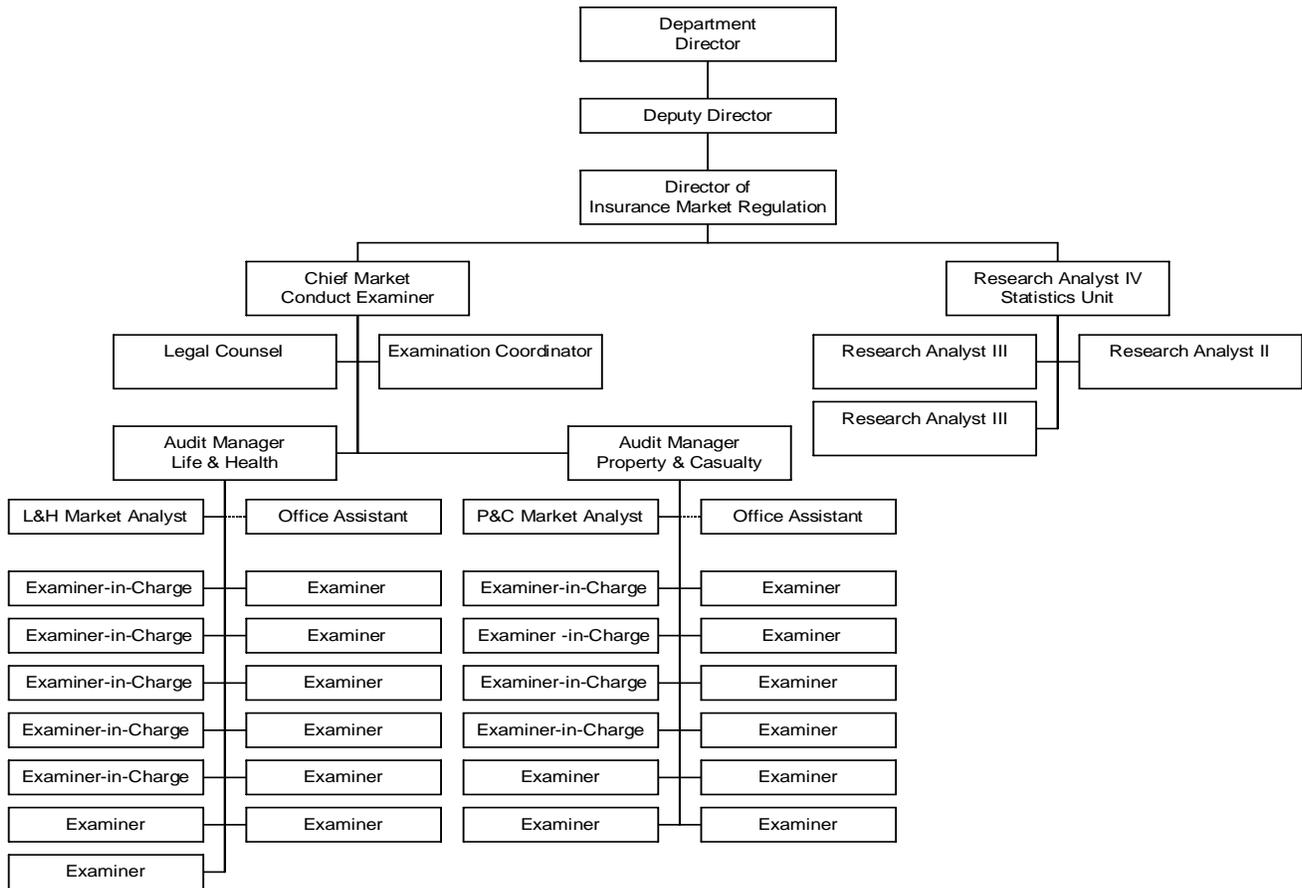
The Market Conduct Section is a part of the Insurance Market Regulation Division. The Market Conduct Section is administered by a chief market conduct examiner (“Chief Examiner”). The Chief Examiner receives staff assistance from an examination coordinator and a legal counsel. The Chief Examiner has overall responsibility for the section and its operation. The examination coordinator tracks examinations in the NAIC system, sends letters to companies, delivers workpapers and equipment to the worksites and provides overall administrative support to the examiners. The legal counsel finalizes examination reports, drafts administrative actions and represents the Insurance Market Regulation Division in all negotiations with the company after an examination is complete.

The Market Conduct Section is divided into two units: 1) Life and Health Unit and 2) Property and Casualty Unit. Each of the units is comprised of an audit manager and at least 12 examiners who are further divided into examination teams. The Life and Health Unit currently has five examiners-in-charge (“EIC”) and Property and Casualty Unit currently has four EICs. Each EIC has overall responsibility for conducting the assigned examinations. Each EIC may have 1-2 additional examiners assigned to his/her team, depending on the scope and size of the examination to be conducted. One examination team in the Property and Casualty Unit specializes in conducting title insurance examinations. Audit managers supervise market conduct examinations and have been solely responsible for performing market analysis with assistance from the Statistics Unit

within the Insurance Market Regulation Division and from the Department’s Consumer Affairs Division. Audit managers also assist with data retrieval.

The organizational chart below reflects the current structure of the Market Conduct Section and the Statistics Unit:

Department of Insurance, Financial Institutions and Professional Registration  
Insurance Market Regulation Division  
Market Conduct Section



## IV. Current Process and Procedures

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### A. General Information

The Market Conduct Section performs examinations of life, accident and health, property and casualty and title insurance companies, as well as health maintenance organizations, health service corporations, third party administrators and statistical reporting agencies. Currently, the State of Missouri licenses approximately 2,100 such entities.

Pursuant to the statutes of this state and in accordance with the NAIC 2007 Market Regulation Handbook ("NAIC Handbook"), scope and examination standards include:

- company operation
- management
- complaint handling
- marketing
- sales
- producer licensing
- policyholder services
- underwriting
- rating
- claims
- other specific areas of review related to the lines of coverage under review, e.g. utilization review for health carriers.

A market conduct examination is conducted:

- to ensure equitable treatment of policyholders;
- to determine compliance with the statutes and regulations of the state;
- to actively monitor the insurance marketplace;
- as a preventive measure by identifying areas where the company can make improvements;
- to verify that policyholders and beneficiaries receive the full benefits of the contracts into which they have entered; and
- to identify potential problem areas as soon as possible in order to protect the consumers of Missouri

### B. Market Analysis

The purpose of market analysis is to use existing data available to review the market as a whole and refine the selection of insurance companies that may require a market conduct examination. The Market Conduct Section uses a baseline analysis similar to the NAIC

prioritization tool and percentiles to compare the industry on several factors by line of business. These statistical tools include the Regulatory Information Retrieval System (RIRS) index, a complaint index, and a market score. The RIRS index measures nationwide regulatory actions involving an insurer against that insurer's market share. The complaint index measures complaints from Missouri consumers filed in the Department's Consumer Affairs Division against an insurer's Missouri market share. The Statistics Unit also develops a market score based upon the RIRS index, the complaint index, financial analysis and several other data sources. The Statistics Unit compiles and analyzes data and continues to develop analytical methods for market conduct analysis. The Statistics Unit has begun compiling data submitted by insurers on the NAIC Uniform Market Conduct Annual Statement ("MC Annual Statement"). Once the data are compiled, the audit manager uses the data to identify outliers.

The audit manager can compare companies based upon the financial annual statement, the NAIC Examination Tracking System (ETS) and other sources of data. The audit manager may evaluate the MC Annual Statement, both Missouri's complaint index and the NAIC complaint index, actual complaints that appear to be systematic problems, shifts in premium, market share, losses, resisted claims, lines of business, private litigation, previous market conduct examinations and stipulations, regulatory and examination information from other jurisdictions, carrier Web sites, producer Web sites, trade publications and media resources.

Missouri's Market Conduct Section now employs the continuum approach approved by the NAIC. Applying a "Level 1 Analysis" is highly discretionary; however, it is focused on core lines of business. The NAIC recommends conducting 40 Level 1 Analyses each year. Missouri's Market Conduct Section completed 44 Level 1 Analysis reviews during 2006 and 41 in 2007.

Results of the Level 1 Analysis, along with available data from other information sources, may identify a company that should be analyzed more closely. This may entail examining individual complaint files or other data sources as outlined in the NAIC Level 2 Analysis guidelines and assessing the scale of the likely market impact of a problem. If appropriate, an entity might be queried about their numbers to determine whether there is a reasonable explanation for any anomalies and to verify the accuracy of the data. Of the 41 Level 1 Analyses conducted during 2007, eight resulted in a Level 2 Analysis. This market analysis approach is used not only to select a company for an examination, but also to more accurately define the scope of the examination as well as actively monitor the marketplace.<sup>2</sup>

After market analysis, audit managers will make a decision regarding further appropriate regulatory action, which may include requesting authority to call for an examination.

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<sup>2</sup> In 2006, as the Market Conduct Section was implementing this approach, it conducted 23 desk audits. Some of these desk audits were similar to a Level 2 Analysis. Of the 23 desk audits, 2 became targeted examinations.

Members of Missouri's Insurance Market Regulation Division have had significant involvement at NAIC quarterly meetings in developing market analysis tools. The Director chairs the Consumer Protection Working Group, which only recently finalized efforts to bring uniformity to consumer complaint coding, a very basic requirement for implementing market analysis based upon national data. Despite significant efforts devoted to developing a market analysis approach, no empirical data is available to demonstrate that this approach will reduce the burdens of regulation, enhance consumer protection or increase compliance with law. However, Missouri's Insurance Market Regulation Division fully supports this approach and has worked to implement it because analytically positive results are likely to be achieved.

After carefully reviewing the Department's market conduct efforts, the Director has concluded that although more focused, targeted examinations have been a steady component of the Department's strategic plan, the Department has not yet attained its objectives. Obstacles to that progress will be discussed later in this report, but the following recent administrative changes are noteworthy:

1. On October 11, 2007, two positions budgeted for market conduct examiners were re-classified as market conduct analysts.
2. On November 13, 2007, after evaluating the information gathered for this report, the Director modified the market conduct process to require that all market conduct examinations be based upon a finding of cause by the Director. As this requirement is implemented, it has heightened the need for solid market analysis, including documented conclusions.

While these changes are recent, the changes coincide with the adoption of uniform complaint coding at the NAIC and the very serious consideration being given by insurance regulators to bring uniformity to market analysis over the past several years.

In September 2003, the NAIC adopted a modernization plan titled, "The NAIC's Reinforced Commitment: Insurance Regulatory Modernization Action Plan." This plan established the following principles and goals for market analysis and recommended that each state should "adopt uniform market analysis standards and procedures" and use market analysis in other market regulatory functions.

Market analysis is designed:

- to provide tools for each state to review its entire market;
- to identify companies not complying with the state's laws and regulations designed to protect consumers; and

- to assist in narrowing the scope of any regulatory action to address those companies that appear to be experiencing compliance challenges

Ultimately, the NAIC's goal of the market analysis process is to focus a state's resources on regulatory concerns that cause harm to its consumers.

In December 2006, the NAIC published a protocol for insurance regulators titled, "Framework for Market Analysis." This white paper, authored by the Market Analysis Priorities Working Group, states: "Market analysis should be conducted on a regular basis, but no less frequently than annually." This analysis can be conducted using a variety of tools available, such as:

1. The NAIC company listing spreadsheets and databases for financial, complaint and regulatory activity.
2. The Level 1 Analysis which requires an analyst to look at specific company information on a detailed basis to determine if any of the anomalies from the initial analysis can be explained.
3. The Market Conduct Annual Statements which provide a more detailed look at companies' market activity on an annual basis.
4. The Level 2 Analysis which requires states to delve deeply into a company's complaints, its Web site, other regulatory agencies and other areas that provide information about the company's market practices.

The development of these tools demonstrates significant progress at the NAIC. Rather than waiting for full development of national standards, the Director has concluded progress must be made in Missouri to implement effective market analysis efforts. This means our examination resources should focus on regulated entities suspected of engaging in unfair, deceptive or unlawful activity.

### C. Examination Process

The Director may call a market conduct examination based upon a number of established indicators designed to identify potential problems or areas of concerns. Some items which may trigger an examination include the following:

- a higher than average level of consumer complaint activity;
- collaborative actions with other jurisdictions;
- concerns uncovered in financial examinations;
- referrals from a law enforcement or regulatory agency;
- issues which come to light as a result of private litigation;

- concerns which arise based on the review of statistical information; and
- information received from other states

After audit managers conduct analysis and review data from various sources, they determine whether or not any concern rises to the level that an insurer should be further reviewed by examination and, if so, the scope of the examination most appropriate for the situation. An examination call sheet and supporting documentation is completed and submitted to the Chief Examiner. After review of the documentation, the examination is disapproved, returned for additional analysis or follow-up, or approved and submitted to the Director for the issuance of an examination warrant.

If the Director concludes that cause exists<sup>3</sup> and issues an examination warrant, the company is notified in writing of the planned examination. The Market Conduct Section provides the company with a pre-examination packet describing the examination process, identifying information which may be requested prior to the commencement of the examination and explaining the Market Conduct Section's expectations regarding the examination. The audit manager reviews the company's responses and assigns an EIC and an examination team to the company's examination.

The scope of an examination determines whether the examination is "targeted" or "comprehensive." The scope of the examination also determines whether the examination must be conducted at the carrier's offices, the Department's offices or a combination of both locations.

**Targeted Examinations:**

The NAIC Handbook states a targeted examination should be based on the results of a market analysis indicating the need to review either a specific line of business or a specific business practice including, but not limited to the following areas of the company's business:

- complaints
- agency licensing
- rates
- forms
- claims
- marketing
- policyholder service

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<sup>3</sup> The exception to this review for cause is the statutory requirement that the Market Conduct Section examine Health Maintenance Organizations every three years. During the 2007 legislative session, the General Assembly eliminated the requirement that title insurance companies be examined every four years.

At times insurance department complaints reveal a specific practice that is inappropriate. In such a case, a targeted examination reviews whether a specific practice (e.g. prompt acknowledgement of pertinent communications or failure to reimburse the insured's deductible) is occurring with a frequency that may indicate a business practice and subject the company to enforcement action.

The Director's warrant may authorize a targeted examination performed from the Department's offices. A desk audit involves obtaining documents from the regulated entity by hard copy, microfiche, disc or other electronic media for review. A desk audit is best suited for use when materials being reviewed can be forwarded for study and examination at the Department's offices. If the Market Conduct Section finds and documents additional cause, the Director may amend the examination warrant and expand the scope of the examination to a broader on-site examination.

**Comprehensive Examinations:**

A comprehensive examination is a full scope examination that involves review of all or most of the regulated entity's lines of business. A comprehensive market conduct examination usually examines all seven of the following areas:

- complaints
- agency licensing
- rates
- forms
- claims
- marketing
- policyholder service

These areas may be covered in targeted market conduct examinations, but a comprehensive examination will include an analysis of all or most of these areas of review. Comprehensive examinations should be utilized only in situations where the findings of the market analysis indicate that such a comprehensive review of the regulated entity is warranted.

The following information was tabulated for the years of 2005 and 2006:

**Market Conduct Exam Data Summary**

<b>Calendar 2005</b>													
Type of Exam	# Exams	Length of exam (days)	Avg. exam (days)	Hours Worked	Avg. Hrs Worked	End of Exam to Report	Avg. exam to Report	Report mailed closed	Avg report to close	Exam Cost	Avg exam cost	Consumer Recoveries	Avg. Recoveries
Targeted	34	5,460	161	15,082	444	5,079	149	3,207	94	\$714,550	\$21,016	\$830,801	\$24,435
Comprehensive	24	2,710	113	30,235	1,260	500	21	3,553	148	\$2,449,530	\$102,064	\$452,425	\$18,851
Mandated	3	662	221	2,313	771	192	64	497	166	\$133,575	\$44,525	\$86,285	\$28,762
Desk	0												
<b>Total</b>	<b>61</b>												

<b>Calendar 2006</b>													
Type of Exam	# Exams	Length of exam (days)	Avg. exam (days)	Hours Worked	Avg. Hrs Worked	End of Exam to Report	Avg. exam to Report	Report mailed closed	Avg report to close	Exam Cost	Avg exam cost	Consumer Recoveries	Avg. Recoveries
Targeted	14	543	39	7,188	513	1,261	90	1,380	99	\$713,223	\$50,944	\$475,694	\$33,978
Comprehensive	20	2,098	105	35,200	1,760	1,763	88	4,002	200	\$2,852,860	\$142,643	\$329,793	\$16,490
Mandated	1	261	261	6,276	6,276	155	155	386	386	\$333,964	\$333,964	\$0	\$0
Desk	23												
<b>Total</b>	<b>58</b>												

Effective July 2007, the Director requested the Market Conduct Section to begin tracking the above-referenced information. Complete historical information is not readily available, but a more thorough evaluation of the Market Conduct Section’s effectiveness and efficiency is now possible.

During the course of the examination, the examination team reviews a company’s practices to identify any violations of the state’s insurance laws. If examiners find activity which they believe is or may be an illegal business practice, the item is written out as a criticism (referred to as a “crit sheet”) and provided to the company for its review and explanation. Based upon the criticisms submitted and after consideration of the company’s response, the examiner identifies criticisms that are appropriate findings of fact to be included in the examiner’s draft report. In support of the report, the examiners will document each of their findings for use as exhibits to support the statements contained in their report. After a supervisory review of the report, a copy is remitted to the examined company. The company then has an opportunity to submit a written response to explain or rebut the examiners’ findings, explaining any mitigating circumstances and describe any corrective action which the company has or will take as a result of the examination’s findings.

**D. Penalty Assessments**

Prior to the effective date of § 374.049, RSMo, the Insurance Market Regulation Division initiated settlement negotiations based upon the authority granted to it in § 374.280, RSMo. This statute allowed the Director, after a hearing, to order a forfeiture to the state for each violation of chapters 374, 375, 376, 377, 378 and 379, RSMo. The language of the statute also required that the Director find that the violation was “knowingly” being committed.

The Market Conduct Section established guides for evaluating whether a violation is “knowing.” These guides are derived from a sampling practice used in connection with the Unfair Trade Practices Statute (§§ 375.930 - 375.948, RSMo) and the Unfair Claims

Settlement Practices Act (§§ 375.1000 - 375.1018, RSMo). In each of these model acts, it is an unfair practice to commit one of the prohibited acts if committed with “conscious disregard” of the law or if the act “has been committed with such frequency to indicate a general business practice to engage in that type of conduct.” (Refer to §§ 375.934 and 375.1005, RSMo) Therefore, a violation of the Unfair Trade Practices Act or Unfair Claims Practices Act occurs when any one of the prohibited practices contained in these acts is 1) committed in conscious disregard of the law; or 2) committed so frequently that it creates the implication of being a business practice of the company, thereby inferring some level of mens rea or culpability beyond mere inadvertence. The Department’s approach in its application of these model acts and the business practice requirement relies on the NAIC Handbook adopted by the Department pursuant to § 374.205, RSMo. The handbook establishes an error tolerance ratio of 7% for claims handling and 10% for underwriting. These percentages were determined by the NAIC to indicate that a business practice exists.

With the passage of recent legislation, these guides remain useful, but they must be re-evaluated in light of the legislation’s new classification system.

## V. Findings and Recommendations to the General Assembly

### **Finding #1:**

On page 10 of the Department’s 2005 – 2009 Strategic Plan (“the plan”), the Market Conduct Mission Statement addresses the market conduct examination process and the general philosophy of the Department regarding this regulatory function. The market conduct process is designed to encourage competitive insurance markets by reducing the cost and time spent by insurance businesses to comply with regulatory programs and increase the use of electronic processing and storage of insurance information. One of the objectives identified by the plan is to increase the percentage of targeted market conduct examinations that are targeted toward a specific issue from 60% to 75%. A review of the information presented in this report reflects that the Department has not met the 2009 objective. Although with the inclusion of desk audits and Level 2 Analysis reviews as targeted examinations, the Department reached 64% during 2006.

### **Recommendation:** No legislation required.

The Department’s 75% targeted examination objective will be reached through the Director’s requirement of cause to issue the warrant. The Department has begun drafting regulations governing the procedures associated with the issuance of a market conduct warrant under § 374.205, RSMo to effectuate the current procedures ordered by the Director. However, no legislation is necessary to achieve this goal. Any legislative requirement of substantial evidence of fraud or unfair practices as cause would strip the Director of the flexibility needed to address unforeseen consumer harm in the marketplace.

**Finding #2:**

Detailed data of the target examinations reveal that even though the examinations were targeted, a few of them took as long as and cost as much as some comprehensive examinations.

**Recommendation:** No legislation required.

Procedures will be adopted by rules to prevent a narrowly-focused or specifically-defined targeted examination from becoming a comprehensive examination without authorization from the Director. The subject matter for review in a targeted examination should be clearly defined with sufficient certainty to ensure that the examiners fully understand the scope of their assignment. If, during any examination, issues of concern arise which indicate that a review of other areas of the company's operations would be prudent or warranted, a request must be submitted by the examination team to the audit manager. Such a request will include any and all information available to assist in making a determination for expanding the scope of the examination. If the audit manager believes such justification or concern exists, he/she will submit the request to the Chief Examiner. If after such review, the Chief Examiner believes justification exists to expand or redirect the efforts of the examiners, he/she will be required to submit the request to the Director for approval. Only the Director, or by delegation to the Deputy Director, is authorized to expand the scope of an examination warrant to address the additional issues or concerns outside the initial scope of review. No legislation is warranted as administrative flexibility is essential to the implementation of these changes and the Department's rulemaking authority is a preferable process to codify procedures which are very likely to evolve as the NAIC continues to make progress in state efficiency and uniformity.

**Finding #3:**

The Department's Market Conduct Section has been a leader in conducting market analysis for many years, but the Department has not yet committed designated staff for the sole purpose of market analysis.

**Recommendation:** No legislation required.

While the audit managers should continue to provide expertise and guidance in this area, it is important for the Department to fully commit staff to market analysis and develop expertise in both the Property and Casualty and Life and Health Units. For this reason, the Department has posted employment openings for a market analyst for each unit. Market analysts will assist the audit managers in market and data analysis to reduce the overall expenses and time examiners spend on each examination.

**Finding #4:**

The Department averaged about 93 days from the completion of on-site examination work until a report was approved by the audit manager. In some instances, individual examinations actually took more than one year from the end of the exam work until the report was finalized. A company that has been examined should not have to wait an

extended period of time to receive a report of the examination findings. One reason for this delay is that examination teams complete their on-site examination work for one examination and immediately begin a new on-site examination of a different company. In so doing, they are forced to split their time and responsibilities between the new examination and completing the report for the prior examination. Delay can also occur due to demands on audit managers' time when they review the report while also performing and reviewing market analysis on other companies.

**Recommendation:** No legislation required.

As a result of the changes implemented with the passage of SB 66 (2007), examination teams must complete post examination work, including finalizing and submitting the report on the company in state offices before they move on to another examination before submitting their report on a concluded examination. This should enable staff to focus on completing one examination before moving on to the next one. Also, the addition of market analysts should allow audit managers to devote a larger percentage of their time toward reviewing and completing examination reports and less time on their market analysis.

**Finding #5:**

The Department issues penalties based on any violation of law. The NAIC Framework for Market Analysis states "One of the goals of the market analysis process is to focus a state's resources on regulatory problems that cause harm to its consumers."

**Recommendation:** No legislation required.

This administrative change shall occur following the implementation of §§ 374.046 - 374.049, RSMo (HB 1837 (2006) and SB 66 (2007)). In negotiating settlements, the Insurance Market Regulation Division will evaluate the penalty policies intended by the penalty classification system now effective under Missouri law.

**Finding #6:**

When identifying violations of statutes or regulations, all violations, regardless of their nature or effect, are aggregated in determining whether the tolerance level has been exceeded. Application of such a formula results in the aggregation of various unrelated types of errors in determining whether or not a "business practice" exists. For example, a tardily mailed claim acknowledgement, an inaccurate sales tax affidavit and failure to reimburse the insured's deductible are aggregated to determine that the company has a business practice in violation of the statutes.

**Recommendation:** No legislation required.

In pending examinations for conduct occurring prior to the effective date of HB 1837 (2006), any of violations of the insurance laws must be shown to have been "knowingly" committed by the company. Aggregation of unrelated errors neither establishes a business practice nor does it establish that the company knowingly violated the law. Therefore, the

penalties being demanded in settlements may be inappropriate and such practice of aggregation should not be continued in negotiation.

**Finding #7:**

In most cases where a large number of policies, claims or files are present, the Department draws a sample (e.g. 100 out of 50,000 files) and projects the characteristics of the sample to the entire population of files. The percentage of errors is determined from the sample pool and if it does not exceed the tolerance level (7% or 10%, based upon the area being examined) no penalties are assessed. Where a small number of policies, files or claims exist, examiners review all of them. This is referred to as a "census review." No error tolerance ratio is applied in a census study. Instead, the number of errors is multiplied by a dollar amount, usually up to \$100, to determine the forfeiture amount. The rational basis for this distinction is uncertain, but it results in penalizing companies with a small volume of business in a particular area.

**Recommendation:** No legislation required.

The Department will review this procedure and the application of fines in light of the §§ 374.046 to 374.049, RSMo classification system. The penalty assessment structure will be reviewed to provide some level of uniformity between sampling and a census review. Consideration will be given to the application of the error tolerance ratios to all areas of review, regardless of the population of the pool.

**Finding #8:**

Once an examination team completes an examination, the members of that examination team receive little feedback regarding the results of their findings or a review of the final resolution of the deficiencies or violations identified during the examination process. In addition, examiners receive limited training or updates regarding the Department's position and/or interpretation of the laws and regulations which the examiners apply during the examination process.

**Recommendation:** No legislation required.

In order to identify any deficiencies in the training of market conduct examiners, a periodic assessment will be conducted on each market conduct examiner to assess his/her capabilities. This process will provide an on-going and regular assessment of each examiner's capabilities, his/her familiarity with insurance laws and regulations and the interpretation and applicability of each. Interviews should reveal the examiner's level of awareness with the Department's policy toward targeted examinations and the Department's interpretation of the laws and regulations which it is charged with enforcing.

Implementation of an effective training program for market conduct staff should include the following:

- Pre-examination conferences to ensure that the audit manager, EIC and examiners working with the EIC are aware of the purpose and justification for each examination, the issues which are being targeted and the applications of the insurance laws or regulations which may be applicable during the examination.
- The examiners (or through the EIC) should be encouraged to contact the audit manager in situations which call into question the Department's interpretation of various statutes and regulations. If an issue of interpretation arises between an examiner and the company being examined, a request for clarification and verification should be submitted by the examiner to the audit manager. This should provide clarification to both the examiner and the company and reduce or avoid issues of misunderstanding or misinterpretation which otherwise may remain unresolved until the conclusion of the examination.
- Training should take place at least annually to refresh examiners on new laws, regulations and industry issues.
- The EIC should become more involved in the closing of each examination for which he/she is responsible. Resolution of the examinations and the removal of inaccurate or invalid criticisms should be formally communicated to the EIC by the audit managers so that he/she may inform his/her examination team of the Department's position on the concerns identified during the examination process.

**Finding #9:**

Some companies operating in multiple jurisdictions have expressed concern that they may experience a series of continuous or perhaps even concurrent market conduct examinations from multiple jurisdictions. This could result in a significant burden upon the resources and personnel of any such company, as well as an inefficient use of state resources due to the resulting tax credit for the examination expense.

**Recommendation:** No legislation required.

As market analysis protocol and best practices evolve through the NAIC, the factors may be applied to Missouri through rule promulgation. The Department participates in the NAIC Market Analysis Working Group to discuss and coordinate multiple jurisdiction reviews and state regulators are making significant progress to reduce this problem. Moreover, the member regulators of the NAIC have begun discussions of market conduct accreditation, so that states can be assured of a level of effectiveness across state lines.

**Finding #10:**

Deficiencies or violations which were identified during a previous market conduct examination are identified again during a subsequent examination.

**Recommendation:** No legislation required.

The Market Conduct Section reviews prior market conduct examinations, if any, performed on that company. If, during an examination, reoccurring violations are identified, a cure order and/or other reasonable and increasingly punitive course of action will be recommended to bring about compliance.

**Finding #11:**

In performing market analysis, the Market Conduct Section utilizes the Market Conduct Annual Statement. This statement is required to be submitted annually by each company. Missing or incorrect information on the Market Conduct Annual Statements submitted by some companies greatly limits the Department's ability to rely upon such information in its analysis process.

**Recommendation:** No legislation required.

The Director will propose a rule requiring insurance companies to submit timely, accurate and complete information in the Market Conduct Annual Statements. This requirement will enable the Market Conduct Section to accurately and fully review and compare the information contained in the Market Conduct Annual Statement with information received from other sources. This should enable the Market Conduct Section to make a better assessment of a company's operations and activities and reduce the occurrence or breadth of data calls for obtaining such information.

**Finding #12:**

Some insurance company representatives believe that if their company detects a violation or concern within its own operations and reports that issue to the Market Conduct Section, it will prompt a market conduct examination.

**Recommendation:** No legislation required.

Depending on the violation or error and subsequent company action, the Department may or may not call an exam. Under §§374.046 to 374.049, RSMo, self-reporting and implementing corrective measures will result in a significant reduction in any penalty. If the company takes appropriate action to correct the deficiency, provides adequate documentation of such action and the Market Conduct Section concludes that no additional action is necessary, the matter should be closed.

**Finding #13:**

Some insurance company representatives believe that the Department has, at times, moved directly to a market conduct examination without fully utilizing the continuum of action recommended by the NAIC market conduct model.

**Recommendation:** No legislation required.

Although this may have been common several years ago, the promulgation of procedural rules for the issuance of a warrant will eliminate that concern. Except in some unusual circumstances that may require a market conduct examination be commenced immediately, all analysis and action should follow the NAIC market conduct continuum of action as closely as possible.

**Finding #14:**

Situations have arisen during on-site examinations where information is provided to the examiners via electronic access, but the examiners were unable to access or view the data requested. Often times this situation results in the examiners criticizing the company for its failure to provide the data requested.

**Recommendation:** No legislation required.

The Market Conduct Section is modifying its pre-examination procedures to include a meeting with company personnel, the audit manager and the EIC at the commencement of every examination. At this meeting, the audit manager will give the company a written statement clarifying the Department's position that the failure to adequately provide examiners with the means necessary to access electronic data (when the company has chosen to provide access to the data in this manner) will be considered a failure to provide the data requested at all.

**Finding #15:**

Sometimes confusion and misunderstandings have arisen as a result of a breakdown in the communication process between the examination team (or Market Conduct Section management) and the company being examined.

**Recommendation:** No legislation required.

Examiner training is being modified to encourage open channels of communication between all parties involved in the exam process. Examiners should promptly bring to the attention of company personnel any concerns or difficulties which may arise during the course of the examination. Likewise, the examiner must provide representatives of the company sufficient assurance that they should freely discuss any concerns or questions with the examiners performing the examination and when desired or necessary, contact the audit manager to ensure that all parties have a mutual understanding of the process and resolution of any issues or concerns.

## VI. Conclusion

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The study and recommendations required by the General Assembly serves as a valuable vehicle to move the Department's Insurance Market Regulation Division forward to greater efficiencies in its Market Conduct Section. However, none of the findings require or even justify legislative action.

Many of the findings do suggest the need for procedural regulations to govern the market conduct authority established by § 374.205, RSMo. As the Department moves forward with these regulations, it will provide an addendum to this report on its rulemaking progress by September 1, 2008.