Texas Sunset Advisory Commission

STAFF EVALUATION

Industrial Accident Board

State Board of Insurance

A Staff Report
to the
Sunset Advisory Commission

1982

STATE BOARD OF INSURANCE

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FOREWORD

Over the past several years, there has been a sustained interest among the states in a new concept in legislative review popularly described as sunset. Since 1976, more than half the states have enacted legislation which embodies the primary element of sunset, the automatic termination of an agency unless continued by specific action of the legislature.

The acceptance of this concept has been aided by a general agreement that the normal pressures of the legislative process tend to prevent a systematic review of the efficiency and effectiveness with which governmental programs are carried out. The sunset process is, then, an attempt to institutionalize change and to provide a process by which a review and redefinition of state policy can be accomplished on a regular systematic basis.

The Texas Sunset Act (Article 5429K, V.A.C.S., as amended) was enacted by the 65th Legislature in 1977. Under the provisions of the Act, agencies are automatically terminated according to a specified timetable, unless specifically continued by the legislature.

To assist the legislature in making the determination of whether an agency should be continued and, if continued, whether modifications should be made to its operations and organizational structure, the Act establishes a ten-member Sunset Advisory Commission composed of eight legislative members and two public members. The commission is required to evaluate the performance of the agency in accordance with specific criteria set out in the Act and to recommend necessary changes resulting from the findings of the evaluation.

The process by which the commission arrives at its recommendations moves through three distinct phases beginning with a self-evaluation report made by the agency to the commission. The second phase involves the preparation of a report to the commission by its staff, evaluating the activities of the agency, and proposing suggested changes for commission consideration. The final phase involves public hearings on the need to continue or modify an agency and the development of commission recommendations and legislation, based on the agency self-evaluation, staff report, and public testimony.

The Sunset Commission's findings, recommendations, and proposed legislation are then required to be transmitted to the legislature when it convenes in regular session.

INTRODUCTION AND ORGANIZATION OF AGENCY REVIEW

The Texas Sunset Act abolishes this agency on September 1, 1983 unless it is re-established by the 68th Legislature.

The staff reviewed the activities of this agency according to the criteria set out in the Sunset Act and has based its conclusions on the findings developed under these criteria.

Taken as a whole, these criteria direct the review of an agency to answer four primary questions:

1. Does the state need to perform the function or functions under review?
2. Could the public still be adequately served or protected if the functions were modified?
3. Is the current organizational structure the only practical way for the state to perform the function?
4. If the agency is continued and continues to perform the same functions, can changes be made which will improve the operations of the agency?

The report is structured to present the performance evaluation of the agency. The application of the across-the-board recommendations developed by the commission to deal with common problems are presented in a chart at the end of the report and are not dealt with in the text except in one instance. When the review develops a position which opposes the application of a particular recommendation, the rationale for the position is set forth in the text.

SUMMARY OF STAFF FINDINGS AND CONCLUSIONS

SUMMARY

The State Board of Insurance was created in 1957 and is currently active. The stated objective of the State Board of Insurance is to enforce the state laws governing the insurance industry and certain fire protection industries in order to protect the interest of the general public. The agency's major functions include: 1) the licensing of insurance companies and agents; 2) examination of the financial conditions and claims practices of licensees; 3) implementing statutory standards in areas such as rate-making and policies issued; 4) investigating complaints against agents and companies; 5) regulating residual market mechanisms designed to provide insurance for risks rejected by the voluntary market; 6) applying for a court order of liquidation, rehabilitation or conservation of companies because of insolvency or other reasons.

The results of the review indicated that the agency is generally operated in an efficient and effective manner. It was determined that sufficient reason exists for the state to continue to regulate the insurance industry in Texas and that continuation of the State Board of Insurance as the agency responsible for the regulation of the insurance industry is also a reasonable approach. The review also indicated that if the agency is continued a number of modifications should be made which would improve the efficiency and effectiveness of the operations of the agency.

Approaches for Sunset Consideration

I. MAINTAIN THE BOARD WITH MODIFICATIONS

A. Policy-making structure

1. Amend the code to direct the board to make a biennial report to the appropriate committees of the legislature pertaining to needed changes in the statutes governing insurance. (statutory)

B. Agency operations

1. Overall administration

a. Amend the Code to assess a maintenance tax for the support of the agency based on gross premiums written by all companies writing life, accident and health and credit insurance and on the gross revenues received by health maintenance organizations. (statutory)

b. Amend the Code to permit all revenues dedicated to the support of the agency to be deposited to the agency's

general operating fund, thus eliminating the need for 21 special funds. (statutory)

c. Amend the Code to provide the board with flexibility to adjust the various fees and assessments authorized within statutorily established limits. (statutory)

d. In instances where the board has the flexibility to adjust fees or tax rates, the agency should take steps to reduce fund balances to meet the 60 percent rider limitation in the Appropriations Act. (management improvement - non-statutory)

e. Amend the Code to provide for consistent treatment of similar revenues by: 1) providing that the deposit of application and filing fees in connnection with the regulation health maintenance organizations and prepaid legal services into an appropriate special fund; 2) providing that ending balances in the Fireworks Licensing Fund and the Agents Licensing Fund to be retained at the end of each fiscal year. (statutory)

2. Evaluation of Programs

a. Amend the Code to provide the board with the authority to set the initial minimum capital and surplus requirements. (statutory)

b. Amend the Code to modify the chartering procedures by eliminating the need to: 1) require the Attorney General to review and approve the documents connected with charter applications; and 2) eliminate the need for a second hearing in the case of life companies. (statutory)

c. Amend the Code to charge all companies the actual costs of examinations plus an assessment for overhead with no offset provided against their premium tax liability. (statutory)

d. Amend the Code to remove any statutory impediments to the use of a national licensing examination.

e. Amend the Code to require quarterly prepayments of gross premium taxes for all companies paying more than $1,000 in annual taxes. (statutory)

f. Amend the Code and Articles 4769 and 4769a, V.A.C.S. to provide a four year statute of limitation for recovery of

taxes paid in protest for life, accident and health premiums. (statutory)

g. Amend the Code to authorize the performance of field audits to verify gross premium tax collections. These audits could be conducted either by the staff of the State Board of Insurance or the State Comptroller's Office. (statutory)

C. Recommendations for other sunset criteria

1. Public Participation

a. Amend the Code to authorize the publication of consumer-oriented publications and the installation of a toll-free WATS line for the use of the general public. (statutory)

2. EEOC/Privacy

a. The provisional grievance procedure adopted by the board should be adequately publicized within the agency and made a part of the personnel manual. (management improvement - non-statutory)

II. ALTERNATIVES

A. Change in Method of Regulation

1. **Transfer the authority for administration of the Residential Service Company Act to the State Board of Insurance.**

The Residential Service Company Act, enacted by the 66th Legislature, provides for the licensing and regulation of service companies. These companies contract to maintain the structural components, appliances, and other parts of residential properties such as plumbing and electrical systems. Since this contract product is marketed primarily by real estate sales people, in its final form the legislation assigned regulatory responsibility over these contracts to the Texas Real Estate Commission. The legislation also requires that residential service companies maintain a funded reserve for their liability to furnish repairs and replacement services under their contracts, and that company operations be subject to examination. However, the review indicated that the Real Estate Commission does not have an actuarial staff to verify that the required reserves have been accumulated so that contract obligations can be paid. Furthermore, the agency has no staff trained to perform financial examinations. The State Board of Insurance not only has the

necessary financial and actuarial expertise but also performs similar regulatory functions in other areas. Transfering the administration of the Act to the State Board of Insurance would therefore provide greater public assurance of adequate supervision for these companies.

2. **Elimination of first year tax exemption on domestic and foreign life, health, and accident premiums.**

Currently, all first year premiums on domestic, life, health and accident insurance policies are exempted from gross premium taxes. A review of premium tax exemptions in other states did not identify any other instances where first year premiums for any line of insurance were exempt from taxation. Based on the data provided by the agency it is estimated that this exemption costs the state approximately $32 million annually. Eliminating this exemption would subject these types of premiums to the same tax requirements as first year premiums for other lines of insurance and provide additional revenues to the General Revenue Fund.

3. **Using the National Council on Compensation Insurance to perform certain functions related to the establishment of rates for workers' compensation insurance.**

In the area of workers' compensation insurance, the State Board of Insurance employs more than 52 individuals to carry out various rate-making functions. In certain other states, however, similar functions are performed for state government regulatory agencies by the National Council on Compensation Insurance (NCCI), a voluntary non-profit association of 635 insurers. The NCCI is currently a license-rating organization in 32 states and provides technical and production assistance to 12 other jurisdictions, including Texas. The review indicated that use of the National Council for many of the functions related to workers' compensation insurance is a possible alternative to the current use of state employees. The State Board of Insurance utilizes services from similar organizations in other areas, and this approach has been generally satisfactory. The NCCI could also perform additional services, such as field audits, which are not available through the agency. The transfer of these functions to

the NCCI would result in the reduction of appoximately 50 employees, however, the overall rates for this type of insurance may not be affected since at least some of the costs for these services would be transferred from the maintenance tax to rating bureau assessments.

III. OTHER ISSUES

During the review issues concerning various aspects of the agency were identified. Most of these issues have been the subject of continued debates without clear resolution on one side or the other. This section set out these issues and summarizes the arguments for and against presented by various groups contacted during the review. The major issue(s) identified the following:

1. **Relationship of Investment Income to Rate Development.**

Insurance companies receive billions of dollars in consumer funds in advance of the actual performance of services and put aside funds in reserve to cover these future promises of service. Significant investment returns from these policy-holder supplied funds are generated in all lines of insurance. Texas has, for many years, indirectly included consideration of investment income in its property and casualty rate development formulas. In late 1980, the dramatic growth in investment profits prompted the board to reexamine the treatment of investment income in rate-making. A new method for calculating investment income was adopted on an interim basis in 1981 and savings to policy-holders have resulted from its use. At the same time the interim approach was adopted, the board determined that a more exhaustive study would be beneficial. The 67th Legislature appropriated $200,000 to fund a study of the relationship of investment income to rate development. The National Association of Insurance Commissioners is also studying this issue and the board thus delayed committing the the majority of funds appropriated for the study until the results of the national study can be reviewed. As a result, the State Board of Insurance does not anticipate completion of their report prior to January 1984.

2. **Protest Payments of Gross Premium Taxes.**

As of August 31, 1981, there was $27.8 million in gross premium tax receipts paid in protest, of which $27.2 million or 98 percent represented payments in protest by foreign life companies. The legal

question involved in these protest payments is the contention of foreign companies that the premium tax rates for foreign life, accident and health organizations which is 3.3 percent on a graduated scale is discriminatory since there is currently no way for these companies to pay a rate comparable to that paid by domestic companies which is 1.1 percent. The 67th Legislature resolved this problem for foreign fire and casualty companies by eliminating the discrepancy between the amounts paid by foreign and domestic comanies. There is currently an advisory committee appointed by the board addressing the problems related to the differential between tax rates. It is anticipated that the committee will recommend to the board proposed legislation that will address the problems concerning the differential between foreign and domestic companies.

3. **Less Restrictive Rate Alternatives.**

In recent years the issue of "open rating" and other less regulated rating alternatives have become the subject of serious debate in many states. Under most open rating plans the companies are required to file with the state insurance department those rates proposed for various lines of insurance. In contrast most rate-regulated systems require some form of prior approval.

Texas is currently the only state that promulgates state-made rates for certain lines of insurance with prior approval required for other casualty lines. The debate concerning the best system of insurance rate regulation for Texas began with the enactment of the first statutes passed on the 1900's and continues today. Proponents of the current method of regulation point to the assistance provide the consumer in comparing products and price provided by the standard contract language which is possible with state-made rates and express concerns over the availability of insurance under a fully competitive rate structure. Supporters of less restrictive alternatives argue that competition provides the greatest incentive for firms to be efficient, thus providing the best possible services to consumers at the lowest cost. In addition, companies operating under open rating plans can respond more quickly to unforseen adverse economic or claims experience by adjusting rates, thereby lessening the pressure to restore rate adequacy through restrictive underwriting practices.

AGENCY EVALUATION

The review of the current operations of an agency is based on several criteria contained in the Sunset Act. The analysis made under these criteria is intended to give answers to the following basic questions:

1. Does the policy-making structure of the agency fairly reflect the interests served by the agency?
2. Does the agency operate efficiently?
3. Has the agency been effective in meeting its statutory requirements?
4. Do the agency's programs overlap or duplicate programs of other agencies to a degree that presents serious problems?
5. Is the agency carrying out only those programs authorized by the legislature?
6. If the agency is abolished, could the state reasonably expect federal intervention or a substantial loss of federal funds?

BACKGROUND

Organization and Objectives

Practically all insurance written in Texas for its first 30 years as a state was written by companies migrating from other states and foreign countries. Texas insurance corporations were created only by special act of the legislature. Many of the Texas companies were competing with stronger, more experienced out-of-state companies. Because both were operating under inadequate laws, the domestic companies eventually failed financially or were reinsured and absorbed by the out-of-state companies. State comptroller's records indicate that 61 companies paid business taxes in 1874. Of that number, only five were domestic companies. Regulation was reported to be very ineffective. Many companies did not pay the prescribed business tax or otherwise comply with the law.

As the state's economy and population began to grow, wildcat insurance schemes abounded. Two pre-constitutional general laws were adopted in 1874 and 1875 that attempted to regulate insurance company formation, activities and coverage. The state comptroller was charged with keeping the records and enforcing some provisions of those acts. The earliest tax levied on insurance companies and the earliest statutes regulating agents also date back to this period.

Beginning in 1876, insurance regulation in Texas was moved from the Comptroller of Public Accounts to the newly-created Department of Insurance Statistics and History. Between 1887 and 1905, the Commissioner of Insurance, Statistics and History also assumed responsibility for the administration of the Bureau of Agriculture and the supervision and regulation of the state's 118 banks. Two years later in 1907, an Act was passed creating a separate department of agriculture and renaming the old agency the Department of Insurance and Banking. A significant change impacting the regulation of insurance during this period the enactment of the Robertson Law requiring compulsory investments in Texas securities.

For the next 16 years, the chief executive of the agency was called the Commissioner of Insurance and Banking. The commissioner's duties were again expanded between 1909 and 1923 to include supervision of all building and loan associations and chairing the various rate-making boards established during this period.

Acting on the recommendation of the commissioner, the 38th Legislature created a separate Commissioner of Banking with responsibility for the supervision of banks. In 1927, the 40th Legislature further modified the regulation of insurance by creating a Board of Insurance Commissioners. The former Commissioner of Insurance was designated as the life insurance commissioner and chairman of the board; the secretary of the former commission became the fire insurance commissioner and the State Fire Marshal became the casualty insurance commissioner. For the next 30 years, the regulation of the fire, life, and casualty insurance industries was administered by the designated commissioners. Members of the board functioned as a whole only when taking official action.

The rapid growth in the number of insurance laws in the late 1940's and the growth of Texas after World War II brought increased recognition of the need for a more systematic regulatory structure and in 1951, the 52nd Legislature enacted the first Insurance Code for the state. Significant changes in the Insurance Code and the structure of the board occurred again in the 1950 as a result of concerns over various types of insurance promotions and the insolvency scandals resulting from 23 Texas companies or organizations placed in receivership between 1954 and 1958. In the aftermath, the legislature passed some 16 bills affecting insurance including measures to increase requirements for minimum capital and surplus, to give more control to the board for the issuance of certificates of authority and to strengthen examination laws. In 1957, the 55th Legislature reorganized the board and its method of operation into the current structure with members prohibited from dividing or confining their activities or functions into special fields of insurance regulation.

The State Board of Insurance, composed of three members appointed by the Governor with the consent of the Senate for overlapping six-year terms, is currently active. Board members are required to have at least ten years experience in business, professional, or government activities.

The Commissioner of Insurance, appointed by the board, is the agency's chief executive and administrative officer. The commissioner serves at the pleasure of the board and is responsible for administering, enforcing and carrying out the provisions of the Insurance Code and the rules and regulations promulgated by the board. The chairman of the board also appoints a State Fire Marshal who is chief administrator for the fire protection duties of the agency.

Funds for the operation of the agency are derived from maintenance taxes based on the taxable gross premiums of insurance companies, examination fees based on the cost of conducting financial examinations of companies, license fees, sale of publications, and other authorized charges. Revenues from these sources are deposited into 21 special funds. Funds for the operation of the agency are transferred from each special fund to the Insurance Operating Fund no. 36 on a proportionate basis as needed. At the end of the fiscal year, any unexpended balances in the operating fund are transferred back to the appropriate special fund. In addition to collecting fees and taxes to support the agency's operations, the agency collects occupation taxes on gross premiums which flow to the General Revenue Fund. For fiscal year 1982, the agency has a staff of 651 and an operating budget of $17.5 million.

The business of insurance is under a unique regulatory system. It is the only major interstate financial industry that is regulated primarily by the states. The states' jurisdiction over insurance regulation was reaffirmed by the federal courts for more than 75 years until 1944 when the Supreme Court held that "no commercial enterprise of any kind which conducts its activities across state lines has been held to be wholly beyond the regulatory power of Congress under the Commerce Clause..." In response to this ruling, Congress passed the McCarran-Ferguson Act of 1945 which exempted the insurance business from the federal anti-trust laws, the Sherman Act, the Clayton Act, and the Federal Trade Commission Act to the extent that insurance is regulated by state law.

Although there are variations in specific laws, resources and regulatory philosophies among the states, regulation of the insurance industry in Texas generally includes the same basic functions encountered in other states: 1) licensing of insurance companies and agents; 2) examination of the financial conditions and claims practices of licensees; 3) implementing statutory standards in areas such as rate-making and policies issued; 4) investigating complaints against agents and companies; 5) regulating residual market mechanisms designed to provide insurance for risks rejected by the voluntary insurance market; and 6) applying for a court order of liquidation, rehabilitation, or conservation of companies because of insolvency or other reasons. Areas identified where Texas' regulatory structure is different from those of other states include the use of both a full-time policy-making board and a full-time commissioner operating under the supervision of the board. The structure also offers a more comprehensive

regulatory authority over uniform policies and endorsements for property/casualty insurance and rate-making in those lines of property/casualty insurance where the board promulgates rates.

The stated objective of the State Board of Insurance is to enforce the laws of this state governing the insurance industry, and certain fire protection industries, in such a manner as to protect the best interest of the public. To achieve this objective, regulatory activities connected with major areas of responsibility under the Code have been organized into five programs supervised by four deputy commissioners and the state fire marshal. In addition, the commissioner directly oversees activities connected with the liquidation of insurance companies, the regulation of surplus lines insurance and the development of rates for various lines of property and casualty insurance.

Financial Monitoring Division

The financial monitoring division of the State Board of Insurance is responsible for: 1) the licensing and regulation of all insurance companies licensed to do business in Texas; 2) administration and collection of all premium taxes and fees from licensed insurers; and 3) administration of the Insurance Holding Company Regulatory Act and the Insurance Company Insider Trading and Proxy Regulation Act.

The application for reservation of a name is the first step in securing permission to conduct business as a domestic insurance company in Texas. Name reservations may be kept in force by renewal at the end of each 120-day period, for an indefinite period. Names have been reserved for several years until the proposed insurer is ready to complete the licensing or until they can qualify for admission. Under the Texas Insurance Code, any number of persons may form a company for the purpose of transacting insurance business. Applicants must file with the board an application for charter and articles of incorporation containing basic information about the proposed company. Minimum capital and surplus requirements, set by statute, range from $150,000 to $300,000 depending on the type of insurance in which the company intends to engage. The Texas Insurance Code specifies that the board consider three criteria in determining whether to license a company: 1) whether the proposed capital structure meets the minimum statutory requirements; 2) whether the proposed officers and directors have sufficient insurance experience, ability, standing and good record to render the success of the proposed company probable; and 3) whether the applicants are acting

in good faith. Currently, more than 701 domestic insurance companies are licensed to do business in Texas. A study of the disposition of license applications filed between 1979 and 1981 indicated that only 10 applications were denied or withdrawn.

Insurance companies incorporated under the laws of any other state or country, otherwise known as foreign companies, seeking to be certified to do business in Texas, are also required to meet certain minimum statutory criteria. Applicants are required to: 1) furnish the board with information concerning the financial condition and operational history of the company; 2) file articles of incorporation; 3) meet the minimum capital and surplus requirements imposed on domestic companies; and 4) in the case of companies organized under the laws of foreign governments, deposit United States or Texas securities valued at $100,000 with the state treasurer. More than 1,293 foreign insurance companies are currently certified to do business in this state.

Agency records indicated that the total number of new companies licensed in Texas has more than doubled in the last four years. The Texas economy coupled with low capital requirements, favorable premium tax rates for domestic insurance companies, Texas rating laws and rules, credit life rules, favorable court decisions on gross premium tax suits and favorable changes in federal income tax regulations relating to corporate reorganization are the reasons given for this accelerated growth in companies.

The Texas Insurance Code requires the State Board of Insurance to examine all domestic insurance companies once each six months for the first three years after organization, once each year for the second three years, and once every three years thereafter in order to detect problems in time to take corrective action to prevent insolvencies. Board staff also participate in examinations of out-of-state domiciled insurance companies licensed to transact business in Texas. During fiscal year 1981, 54 examiners examined 228 domestic companies and six out-of-state companies.

By examination of companies, the board determines company financial strength and the extent to which financial transactions have been authorized by proper company authority. Also considered is the extent of company compliance with statutes and regulations in the investment of company funds, in selling policies, in dealing with policyholders on claims and other settlements, in establishing reserves for policyholders, and in maintaining adequate organizational

and financial records. In addition to monitoring companies through on-site examinations, insurance companies have been required by law to submit annual financial statements since the first insurance laws were enacted in the 1870's. Agency staff review these financial statements submitted annually. These statements are checked and reviewed for the purpose of verifying accuracy, financial solvency, proper accounting practices, and compliance with reserve and investment laws, and compliance with other laws and regulations. Where problems are identified or suspected, the commissioner can put a company on a more frequent reporting basis. Currently, the agency requires 32 companies to report monthly, 122 to report quarterly, and 200 companies to report semi-annually.

All of the 50 states, including Texas, impose an insurance premium tax on either domestic companies, foreign companies or both. While there is variation among states in both domestic and foreign insurance premium taxation in terms of what type of insurance is taxed and the tax rate, the most frequently used rate is two percent. The first law authorizing the collection of an annual premium tax on insurance companies in Texas, based on a fixed percentage of gross premium receipts, was passed in 1893. Premium tax rates in Texas for domestic companies are currently 1.1 percent of the gross amount of premiums collected by life, accident, and health companies and 3.5 percent on premiums collected by other types of domestic insurance companies. Premium tax rates for foreign companies are set at 3.3 percent of premiums collected by foreign life, accident, and health companies and 3.85 percent of premiums collected by other types of foreign companies. However, first year premiums on life, health, and accident insurance are exempt from taxation and in some instances rates can be reduced depending on the amount of investments in Texas. Revenues from these taxes are deposited to the General Revenue Fund, with 25 percent subsequently allocated to the Available School Fund.

The State Board of Insurance and the agencies from which it evolved have always been self-supporting through the collection of fees and the assessment of special maintenance taxes. Beginning in 1920 as various insurance laws were passed to regulate specific lines of insurance, the legislature often included a provision that the cost of administering the statute would be offset by collection of a special tax against premiums of companies in the regulated line. Currently there are seven maintenance taxes and a Burial Association Tax for the support of the

agency. These taxes are deposited to special funds along with any fees authorized under the applicable statute.

The financial monitoring division staff is responsible for reviewing insurers' annual tax returns for completeness and numerical accuracy, and collecting all fees and taxes due. Taxes collected by this division in fiscal year 1981 totalled $182 million.

The Insurance Holding Company System Regulatory Act was passed in 1971 in response to an increasing trend in the use of the holding company form of corporate structure. The major objectives of the legislation were to prevent acquisition or control of an insurer which would substantially lessen competition, adversely affect the interests of policyholders or shareholders, or result in the insurer paying dividends that jeopardize the company's financial solvency. The Insurance Code requires that all domestic insurers which are members of a holding company system file an annual registration statement disclosing information about the general financial condition and management of the insurer and its holding company. The statement should include information about the relationships, transactions and agreements between an insurer and the holding company. The Holding Company Act also sets standards for transactions with affiliates within an insurance holding company system. It further requires that insurers obtain prior approval of certain transactions with affiliates such as sales, purchases, exchanges, and loans involving a specified percentage of the insurer's assets and payments of dividends and other distributions. The Act also requires the commissioner to approve all mergers and acquisitions of control involving 10 percent or more of the voting securities of an insurer and specifies the information which must be disclosed to the insurer's shareholders. In administering these statutory requirements, the staff of the financial monitoring division reviewed 398 annual disclosure statements, and more than 500 applications for approval of mergers, acquisitions of control and various other transactions in 1981.

This division also administers the provisions of the Insurance Company Insider Trading and Proxy Regulatory Act, passed in 1965. This Act was designed to prevent owners, officers, and directors of insurance companies with 100 or more shareholders from unfairly using inside information to receive personal profits on the purchase and sale of equity securities in an insurance company and to require the dissemination of meaningful information to shareholders in connection with proxy solicitations. All insurers are required annually to report the number of

shareholders in order to determine if they are subject to regulation under the Act. As of August 31, 1982, 23 companies were subject to this Act. Officers, directors and major shareholders of insurers subject to regulation are required to report individual purchases and sales of the insurer's stock. In addition, proxy statements to be mailed to shareholders of insurers subject to regulation are filed for review by the agency prior to being mailed to the shareholders. During 1981, the agency reviewed 273 insider trading reports and 31 proxy solicitations for compliance with the statutes and regulations.

Supervision, Conservatorship and Liquidation

The Texas Insurance Code provides several alternatives to remedy the impaired financial condition and management of troubled insurers: supervision, conservatorship, and liquidation. Recognizing that once the process of receivership has been instituted, there is almost no possibility of returning to solvency, the legislature authorized the supervision and conservatorship functions to protect the assets of an insurer pending a determination of whether the insurer can be successfully rehabilitated without having to resort to temporary or permanent receivership. Supervision and conservatorship is preferable where an insurer can be rehabilitated since placing an insurer in receivership may destroy or diminish the value of the insurance in force, the agency force and other assets.

Whenever the commissioner determines that an insurance company is insolvent, its operations are hazardous to the public, or it has violated the law he notifies the company of his determination, furnishes the company with a list of problems or violations to be addressed and may place the company under supervision for 60 days. Usually the director of the conservation program is appointed supervisor to act on behalf of the commissioner to oversee the operations of the company, giving assistance and guidance to company management. A company placed under supervision may not dispose of assets, withdraw funds from bank accounts, lend or invest funds, transfer property, incur debts or merge with another company without the prior approval of the commissioner or his supervisor. If at the end of the 60-day period, the problems identified have not been remedied, or with the consent of the company, the commissioner may either appoint a conservator who is responsible for the management and day-to-day operations of the company, or in instances where the company is not in condition to continue business, may notify the attorney general to apply to the district court for the appointment of a receiver. Of the 35 companies placed in supervision or

conservatorship during fiscal years 1979 through 1981, 17 have been rehabilitated and released to management, six have been placed in receivership, three have been dissolved, and nine remain in supervision or conservatorship.

Receivership comes through court action and the code provides that the liquidator designated by the board shall be the receiver. The primary statutory responsibilities of the liquidation division include: 1) the orderly administration of the receivership estate; 2) the liquidation of company assets where rehabilitation is not feasible; 3) the protection of the legal interests of policy-holders, creditors and share holders; 4) the protection and marshalling of assets in order to minimize liabilities and maximize ultimate distributions to policyholders, creditors and shareholders; and 5) distribution of available assets to those person who have established a legal claim. During 1981, the assets of the 50 companies administered by this division totaled 23 million. During 1982, the agency was appropriated $436,853 to provide 13 employees who serve as a nucleus of staff to initiate and supervise receiverships. The remaining 39 employees received more than $460,000 in 1982 paid by the estates of the companies in receivership. In receivership estates involving property and casualty companies where no funds are available the property and casualty guaranty fund assumes the costs of administration of the estate. But in the case of life companies where the guaranty fund is not required to fund these costs, a limited amount of funds is made available from the "Abandoned Property Fund" of the State Board of Insurance for necessary administration.

The creation of the Texas Life, Accident, Health, and Hospital Service Insurance Guaranty Association and the Texas Property and Casualty Insurance Guaranty Association in 1972 have permitted the liquidation division to commence the payment of claims within months instead of delaying payments until the company's assets were marshalled. Prior to the creation of these funds, the delay in initial payment could run from one year to several years and very seldom resulted in full payment of the policyholders' claims.

When an insurance company is placed in receivership all approved claims are paid out of the appropriate guaranty fund. Assessments to pay these claims are based on a ratio of the company's business in Texas to the total business in Texas by all participants. The amounts contributed may be used as a tax credit against the premium tax over a period of five years. As the assets of a company are liquidated, reimbursements are made to the guaranty fund. Between 1977 and

1982, the Texas Life, Accident, Health and Hospital Service Insurance Guaranty Association advanced $6.6 million. Repayments to this fund between 1979 and 1982 total $336,000. The Texas Property and Casualty Insurance Guaranty Association advanced $7.8 million between 1975 and 1982 and has received $535,000 in repayments.

Statistical and Rate Development

Generally property and casualty rate development activities have been performed by the State Board of Insurance since the 1920's. Prior to 1957, these efforts were fragmented among a number of programs within the department. In August of that year, a rate development unit was established with responsibility for all property and casualty rate development activities. The responsibilities of this program, which is supervised by the commissioner, include: 1) specifying the actuarial data to be maintained by regulated insurance companies writing property and casualty insurance; 2) collecting and actuarily analyzing rate development statistical data for all property and casualty lines; 3) developing appropriate uniform rates to be charged for automobile, property, workers' compensation and title insurance to present to the board; 4) reviewing general liability, medical professional, inland marine and miscellaneous lines rate filings; and 5) making recommendations to the board.

Casualty Insurance Division

It is the responsibility of the casualty division of the State Board of Insurance to administer and regulate all lines of casualty insurance including automobile insurance; fidelity, forgery and surety bonds; burglary, robbery and theft insurance; plate glass insurance; credit guaranty and mortgage insurance; medical malpractice insurance and workers' compensation insurance. The board promulgates rules, forms, rating plans and rates for only three lines of casualty insurance: automobile, title, and workers' compensation. Forms, rules and rates are filed with the board and must be approved prior to use for bond, burglary and plate glass, mortgage guaranty and other miscellaneous casualty lines.

Although manual rates for automobile insurance are promulgated by the board, not all automobile insurance is written at these rates. One of the primary responsibilities of the casualty division is reviewing and approving applications for rates which are higher or lower than the rates promulgated by the board. These specialized rates and plans administered by this division permit the development of

rates which are more precise and more accurately reflect the specific risk exposure than would be possible if only standardized manual rates were available.

The Texas Insurance Code authorizes any insurer desiring to write automobile insurance at rates different from those promulgated by the board to make a written application for permission to file a uniform upward or downward percentage deviation for any class or coverage on a statewide basis. Currently, approximately 60 percent of all automobile insurance is written under deviations ranging from -31 percent to +150 percent. During 1982, more than 500 applications for deviations were reviewed by the casualty and financial monitoring division to determine if the deviations requested were justified.

The Insurance Code also authorizes specific risks to file consent-to-rate applications at rates in excess of the standard rate or premium promulgated by the board if the person or entity to be insured consents to the rate proposed. This type of rate is authorized for hard to place risks, usually the result of unusual hazards. During the last fiscal year, the staff of the casualty division reviewed approximately 46,000 consent-to-rate applications. This would ensure that the rate charged is, in excess of the standard rates, that the individual has consented to the rate and that the reasons for requiring the greater rate or premium are stated. Approximately five percent of these applications were initially rejected by the agency due to incomplete information.

Under the Code, rates for certain commercial risks such as owners of five or more vehicles with premiums of at least $2,500 are determined on the basis of the individual loss experience of the insured. The basic theory underlying experience rating is to attempt to measure how much better or how much worse an individual risk is in comparison to the average risk for a specified period of time. Rates for risks which are experience-rated are calculated by the insurance company or the Texas Automobile Insurance Office based on the experience rating plan and the manual rates promulgated by the board. These proposed rates are then submitted to the casualty division. The division reviewed more than 35,000 experience rating applications in 1981 to determine if the insured qualified for experience rating and that the rates were calculated correctly. In 1981, this review process resulted in approximately 8,000 applications being initially rejected or returned for correction. Currently more than 35,000 files are maintained by this division on all risks in Texas which are experience-rated.

Casualty division staff also calculate rates for several other rating plans approved by the board for large commercial risks including loss rating plans, composite rating and retrospective rating plans. These plans are designed to encourage accident prevention, recognize peculiar hazards of individual risks, and simplify the calculation of rates for large risks. During 1981, approximately 1,000 applications were received for rating under one of these plans. Although county mutual insurance companies are exempt from board-promulgated rates for automobile insurance, more than 170 rate filings were filed with the casualty division for informational purposes, and reviewed by agency staff.

The staff of this division also responds to inquiries and complaints by policyholders, agents and companies concerning automobile insurance coverages, forms, rules, and rates. During 1981, the agency reported more than 14,000 responses to automobile insurance inquiries and complaints.

In addition, all companies writing automobile insurance are required to file with the board a specimen copy of policies issued. Division staff scan these policies to ensure they are in compliance with the board's rules and regulations. During 1981, more than 400 policies were reviewed and corrections requested in 60 instances.

The board does not promulgate rates for fidelity, forgery, and surety bonds; burglary, robbery and theft insurance; plate glass insurance; and credit and mortgage guaranty insurance. However, companies writing these lines of insurance do file proposed rates with the board, usually through a licensed rating organization such as the Surety Association of America. These rate filings are reviewed by the casualty division and the agency's actuarial staff and sent to the board for its approval prior to use. During 1981, the agency processed more than 84 filings related to rules, rates and policy forms for these lines of insurance. For risks that qualify, agency staff review rates set under specialized experience rating plans approved by the board for theft, glass, bond and burglary lines of insurance. This division also processed more than 1,200 consent-to-rate applications for these lines of insurance.

Title insurance rates are promulgated by the board each year and no deviations or specialized rating plans are administered by agency staff. However, the division is responsible for the administration of the statutes, rules, forms and regulations pertaining to title insurance, reviewing financial reports submitted by title agents and approving the commission split between the abstractor agent and

the title company. The agency also employs one field inspector who examines title abstract plants to ensure compliance with minimum statutory requirements.

The casualty division is also responsible for the regulation of all other lines of casualty insurance including product liability; manufacturers liability; boiler and machinery; errors and omissions; owners, landlords and tenant's liability; and contractual liability. Proposed rates for these lines of insurance are filed for the board's approval after review by the actuarial staff and the casualty division. In addition to reviewing the manual rates filed for the board's approval, the casualty division reviews more than 44,000 applications for "(a)" rates established for unique or unusual lines of exposure, and 19,000 applications for rates established under experience, retrospective, composite or loss rating plans as well as 46,000 applications for consent-to-rate by hard-to-place risks.

Medical liability insurance is regulated by the casualty division of the board. Unlike other lines of general liability insurance, the statutes specify that the rates for medical malpractice insurance are not applicable to all companies writing that line of insurance. Each company files its own rating program for the board's approval. In addition to activities related to rates, the casualty division is responsible for manual rules and forms used by companies writing malpractice insurance in the voluntary market and through the Texas Medical Liability Insurance Underwriting Association.

The primary function of the workers' compensation section of the casualty division is the assignment of classifications and rates to the operations of individual policyholders in order to prevent discrimination between policy holders having like employee hazards in their trade or businesses. There are approximately 700 individual classifications of hazards for which rates are promulgated by the board annually. Over 250,000 workers' compensation policies are filed with this division and examined on a selected basis to determine that the policy provides the desired coverage with appropriate classifications and corresponding rates. Texas operates under a uniform rate law in workers' compensation and no deviations are permitted from promulgated manual rates. However, experience rating is required for larger risks and there are a number of risk classifications for which no rates are printed. This section reviews approximately 40-50 requests for special "(a)" rates for these types of risks and experience rates more than 44,900 risks annually. In addition, more than 700 plant inspections were conducted by division staff to verify hazards or classifications.

Property Division

It is the responsibility of the property division of the State Board of Insurance to administer and regulate all lines of property insurance including fire and extended coverage, multi-peril, inland marine, petroleum properties and home-owners. The board promulgates rates for all of these lines except inland marine insurance, where rates are filed with the board for its approval. The board also promulgates standard policies and forms for all lines of property insurance except inland marine.

The primary activity of the property division is the rating of commercial buildings. In order to ensure that fair and accurate fire and extended coverage rates are used in issuing property insurance policies 45 state inspectors, located in 21 field offices throughout the state, conduct inspections on all newly-constructed mercantile and public buildings, churches, schools and special hazard buildings as well as reinspecting buildings which have been modified. Division records reflect more than 46,000 fire rate inspections were made during 1981.

Division staff also conduct town inspections to establish a key rate for each individual city or town within the state based on the fire department, equipment, personnel, amount of water, building codes and fire protection. This key rate is a part of the published fire insurance rate for each building. During fiscal year 1981 more than 65 towns were inspected and rated. The staff is also responsible for accumulating data annually on premiums written and losses for each incorporated town or city in the state for the most recent five-year period in order to establish a fire record credit. This credit applies primarily to commercial properties and is a part of the final calculation of the fire rate.

The board maintains records on more than 620,000 buildings statewide which have been rated by division personnel. During 1981 the agency processed more than 500,000 requests for current rates on these buildings from insurance agents and companies. Rates are provided by mail, telephone, Western Union and teletype-compatible terminals over telephone lines.

Division staff also review all applications for deviations and dividend payments in lines where rates are promulgated to ensure that the companies have adequate financial resources to write insurance at a lower rate or to pay dividends out of earned surplus. During 1981 the agency received 299 applications for rate deviations and 97 applications to pay dividends. In addition, the division calculates

average rates on policies where two or more items are involved. More than 5,700 average rate calculations were reported during 1981.

Although the board does not promulgate rates for inland marine insurance lines, companies must file the proposed rate with the board. The rate is analyzed by the staff actuaries and if acceptable, the board approves its use. Approximately 1,600 of these filings were submitted for approval during 1981.

Finally, the division staff oversees the overall operation of the Texas Catastrophe Pool by reviewing changes in policy forms and coverages, inspecting some risks and reviewing the pool's annual report and financial audits.

Business Practices, Enforcement and Policy Approval Division

The tasks of this division encompass a wide range of activities including: 1) licensing of all insurance agents, insurance adjusters and premium finance companies; 2) responding to complaints filed against insurance companies concerning claim benefits, underwriting practices or questionable business practices; 3) investigating alleged improper acts of insurance agents or companies; 4) performing actuarial analyses to ensure that companies writing life insurance policies and annuity contracts operate under sound actuarial procedures and set up proper reserves; 5) reviewing all types of insurance advertising to ensure compliance with applicable statutes, rules and regulations; and 6) regulating all policies, contracts and forms of life insurance, accident and health insurance, credit insurance, health maintenance organizations and prepaid legal coverages written in Texas.

The Texas Insurance Code authorizes the issuance of 16 different licenses to individuals who act as agents for various types of insurance companies. During fiscal year 1981 the licensing section of the business practices division issued more than 30,000 new licenses. The qualifications and requirements for the licenses generally include sponsorship by a company, and good character and references. Most licenses require passing an examination. Some types of licenses also require a completion of additional educational requirements and evidence of financial responsibility or experience. As a part of the licensing process, during 1981 the agency scheduled a total of 31,000 applicants to take licensing examinations conducted at 15 locations throughout Texas. The Insurance Code also authorizes the issuance of 90-day temporary licenses for agents writing life, health and accident insurance. During 1981 more than 17,000 temporary licenses were issued.

The licensing section of this division also licenses more than 318 insurance premium finance companies. Regulatory activities in connection with the issuance of these licenses include examination of licensee records, investigation of complaints and review of annual reports.

The claims and complaint section of the business practices division assists the general public, policyholders and claimants who are dissatisfied with action taken by licensed insurance companies in regard to claim benefits, underwriting practices, premium rates or questionable business practices. Approximately 12,000 written complaints were filed during 1981. Of this total, 8,200 complaints involved life, accident and health insurance and 3,700 were associated with property and casualty insurance. Although the State Board of Insurance has no statutory authority to settle a claims dispute between a policyholder or claimant and an insurance company, it can suggest possible actions for the insurance company. As a result of the agency's assistance, individuals filing complaints with the board resulted in settlements of more than $2.9 million in life, accident and health cases and $6.6 million in property and casualty cases. Closed complaint cases are analyzed by company, type of complaint and reason for the complaint. This data is used to identify trends in complaints and provide information on possible early problems within a company. Where questionable trends or patterns develop, field investigations are conducted.

The agency also employs 8 field investigators whose efforts are directed primarily to enforcement of the agent's licensing laws. These investigations involve alleged improper acts of insurance agents or persons acting as insurance agents. These investigators also work in conjunction with claims and complaint personnel in conducting examinations of insurers where questionable insurance practices are noted. During 1981, 1,354 investigations were conducted. As a result of these investigations 13 licenses were revoked, one was suspended and 16 warnings were issued.

The principal objective of the actuarial section of the business practices division is to see that companies writing life insurance policies and annuity contracts operate under sound actuarial procedures and set up proper reserves so that future obligations under such contracts can be met. A secondary objective is to work with other programs in the agency to see that policy holders who lapse or surrender these contracts receive the full benefits provided under their contracts and under Texas law. This section audits and verifies more than 200 annual

valuation reports of reserve liabilities filed by legal reserve companies and stipulated premium companies in Texas, as well as reviewing the actuarial statements attached to the annual statements. In addition, this section reviews the reserve liabilities and other actuarial matters at the home offices of domestic companies in connection with the field examinations conducted by the financial monitoring division. The actuarial section also furnishes actuarial advice in areas other than reserves, including assisting policy holders who have questions or complaints about their life insurance policies, other than non-payment of a claim, and answering questions which arise in the review of life insurance policies submitted to the board for approval.

The objectives of the policy approval section include: 1) reviewing and analyzing all new and revised life insurance, accident and health insurance, credit insurance, health maintenance organization (HMO) and prepaid legal policies, contracts and forms of compliance with applicable statutes and rules; 2) verifying the actuarial soundness and reasonableness of rates of HMOs, prepaid legal coverages and credit insurance; 3) reviewing all types of insurance advertising material submitted to the agency to ensure truthful and adequate disclosure of all material facts; and 4) licensing and regulating health maintenance organizations.

Although the board prescribes standard policy forms for a number of property and casualty lines of insurance, there are no standard forms approved by the board for life, accident and health insurance. However, no policy form, rider, endorsement, or application can be used unless it has been filed and approved for use by the board. The agency currently employs 17 policy analysts who are responsible for the review and analysis of all new and revised life, annuity, credit, advertising, HMO, prepaid legal, and accident and health policy forms. The purpose of the review is to determine whether such forms comply with insurance statutes and rules and regulations promulgated by the board. This review also includes mathematical verification of the non-forfeiture value tables included in policies where the policy holder is entitled to payment upon surrender of the policy. During the fiscal year ended August 31, 1982 the agency considered more than 33,000 forms. Affirmative action was taken in 26,000 instances and more than 7,330, or 22 percent, were disapproved. The rejection rate by type of policy form ranged from an average of 14 percent for individual life, accident and health policies to 35 percent for group life, accident and health policies.

The policy approval section is also responsible for collecting the statistics from companies writing credit life, accident and health insurance, and developing a loss ratio in order for the board to determine a presumptively fair premium rate. The board sets presumptive rates every two to three years. Once the presumptive rate is set, companies may utilize the presumptive rate or file a case rate, based on the company's individual experience, for approval. During 1982 this section granted 78 requests for case rates.

This section employs a small staff to review all types of insurance advertising material submitted by insurers or agents. All material is submitted on a voluntary basis, except advertising for variable life insurance policies. In addition, they respond to inquiries or complaints concerning insurance advertising from the general public. The review indicated that the number of advertising materials reviewed annually has almost doubled, growing from 588 in 1979 to 1,004 in 1982. Agency records indicate that almost 80 percent of the advertising materials submitted required some change. In approximately half of these instances, immediate changes were necessary due to the failure to disclose material information or the use of misleading statements.

Currently 11 health maintenance organizations with a total membership of 213,600 are licensed and regulated by the State Board of Insurance in cooperation with the State Health Department. The Health Department is responsible for reviewing all applicants to evaluate the quality, availability, accessibility and continuity of care that will be available to members and to inspect the facilities twice a year once the HMO is licensed. The State Board of Insurance is responsible for reviewing all contracts and forms used, the proposed plan of operation and the financial stability of the proposed organization; conducting annual field audits once the HMO is licensed; and reviewing and approving filings concerning transactions, such as the leasing of space and borrowing of money.

State Fire Marshal

The objective of the State Fire Marshal's Office is to reduce the incidence and severity of fires, fire deaths, and injuries in the state to an acceptable level from the standpoint of safety. Article 1.09A, T.I.C., designates the State Fire Marshal as the chief administrator of arson and suspected arson within the state. Major activities of the fire marshal's office include arson investigation, fire and life safety inspections, licensing maintenance of a data base on fires and fire losses statewide.

The Fire Marshal's Office employs 10 investigators located in Austin and four field offices to investigate any fire upon request to determine the origin, cause and circumstances; and to identify guilty parties, assist in their arrest and prosecution, and give court testimony when required. During fiscal year 1981, 407 investigations were requested, 534 initial and follow-up investigations were conducted and 52 indictments resulted from this activity.

The Fire Marshal's Office also maintains a staff of 15 inspectors who perform inspections in response to complaints. During fiscal year 1981, more than 4,700 mercantile, manufacturing, and public buildings, as well as locations where public gatherings are held, were inspected to determine if there were fire hazards or other conditions which would endanger the occupants or firefighters; 128 inspections of fireworks stands were conducted, primarily during selling seasons, to determine compliance with statutory requirements; and 97 inspections of retail service stations were made in response to complaints concerning the safe storage, handling and use of flammable liquids. As a result of these inspections more than 4,900 hazards were identified resulting in action to correct the problem or eliminate the hazard.

Under the Texas Insurance Code the Fire Marshal's Office is also responsible for certifying companies and licensing individuals engaged in the following occupations: 1) installing or servicing portable or fixed fire extinguisher systems; 2) selling, servicing or maintaining fire alarm or fire detection devices; and 3) manufacturing, distributing, selling at retail, or importing fireworks for sale in Texas. During fiscal year 1981 the agency administered 521 examinations, issued more than 5,800 licenses to qualified firms or individuals, and initiated 184 inspections and investigations in response to complaints which resulted in nine licenses or certificates being suspended or revoked.

Finally, the Texas Insurance Code authorizes the board to require every city and town in the state to furnish them with a complete and accurate list of all fire and lightning losses. The state Fire Marshal's Office compiles and analyzes this data to determine the total number of fires, fire deaths and injuries and to establish trends in order to assist participating fire departments in identifying specific problems in their areas in order to develop preventive measures.

Summary

The review and evaluation of the State Board of Insurance indicated that its regulatory activities generally serve to ensure an adequate level of public protection. However, the review did show that modifications in a number of areas would increase the efficiency and effectiveness of the agency's operations. Results of the evaluation follow.

REVIEW OF OPERATIONS

The evaluation of the operations of the agency is divided into general areas which deal with: 1) a review and analysis of the policy-making body to determine if it is structured to be fairly reflective of the interests served by the agency; 2) a review and analysis of the activities of the agency to determine if there are areas where the efficiency and effectiveness can be improved both in terms of overall administration of the agency and in the operation of specific agency programs.

Policy-making Structure

In general, the structure of a policy-making body should have specifications regarding composition of the body and the qualifications, method of selection and grounds for removal of the members. These should provide executive and legislative control over the organization of the body and ensure that members are competent to perform required duties, that the composition represents a proper balance of interests impacted by the agency's activities and that the viability of the body is maintained through an effective selection and removal process.

The State Board of Insurance is composed of three members appointed by the Governor with consent of the Senate for overlapping six-year terms. Board members are required to have at least ten years experience in business, professional or government activities. The Insurance Code prohibits any individual who is a stockholder, director, officer, attorney, agency or employee of any insurance agent, broker, or adjuster or who is in any way directly or indirectly interested in such business from serving as a member of the board or being employed by the board.

Unlike many of the boards with policy-making responsibilities over state agencies in Texas, the State Board of Insurance is a full-time board supported by a full-time Commissioner of Insurance who is designated as the chief executive and administrative officer of the board and is charged with responsibility for administering, enforcing and carrying out the provisions of the Insurance Code.

When this board was established by the 55th Legislature in 1957 the proper functions and role of a three-member board and whether the board should be full-time or part-time was carefully considered. Justifications offered for a full-time board include the complexity of insurance regulation, the increased potential for conflict-of-interest problems in part-time boards, and the extensive time necessary to fulfill the board's responsibilities in areas such as ratemaking. The major

disadvantage to this type of organizational structure is the loss of clear lines of responsibility which result from the tendency of full-time boards to participate in the administration of the agency as well as in policy-making functions. The review of the board indicated that, given the scope of regulatory responsibilities assigned to the board, the structure of the board was generally appropriate for this type of agency. The Code clearly specifies the respective responsibilities of the board and commissioner and the review indicated that the current board has tried to minimize its involvement in the day-to-day operations of the agency.

The review did indicate one area where the board's policy-making functions could be improved. Unlike other state agencies such as the Finance Commission, the Texas Education Agency and the State Comptroller's Office, the board is not directed to make periodic reports to the legislature concerning needed statutory changes. The fact that insurance regulation is subject to constant changes and innovations is evidenced by more than 500 bills affecting the insurance industry which are introduced during every session of the legislature. Although the board currently does consider needed changes in the Insurance Code, it has no formal means of communicating these recommendations to the legislature. Directing the board to make a biennial report to the appropriate committees of the house and senate charged with considering legislation pertaining to insurance would provide a formal mechanism for the board to communicate information concerning recommended changes in the Insurance Code to the legislature.

Overall Administration

The evaluation of the overall agency administration focused on determining whether the operating policies and procedures of the agency provide a framework which is adequate for the internal management of personnel and cash resources and which satisfies reporting and management requirements placed on the agency and enforced through other state agencies.

The objectives of the administrative activities of the agency include providing general support services necessary to administer and enforce the provisions of the Texas Insurance Code including accounting, budgeting, legal services, purchasing, data processing, mail processing, personnel and training, duplication and printing, and property and building maintenance. In general, the review indicated that the agency has employed acceptable management practices to ensure its operations are conducted in an efficient and effective manner. However, a number of areas were identified related to the agency's sources of

funding and fiscal management where statutory changes would result in more efficient and effective operations, greater revenues to the state, promote greater equity among the sources of funding for the operations of the agency, and provide greater consistency in the treatment of similar revenues.

Application of the Maintenance Tax to all Lines of Insurance. The State Board of Insurance and the agencies from which it evolved has always been self-supporting through the collection of fees and the assessment of special maintenance taxes. Beginning in 1920, as various insurance laws were passed to regulate specific lines of insurance, the legislature often included a provision that the cost of administering the statute would be offset by collection of a special tax against the premiums of companies in the regulated line. Currently, there are seven maintenance taxes and a Burial Association Tax levied for the support of the agency. Revenues and expenditures for fiscal year 1981 associated with these taxes are shown in Exhibit 1.

Exhibit 1

FISCAL YEAR 1981 REVENUES AND EXPENDITURES

TAX	REVENUES	EXPENDITURES	BALANCE (8/31/82)
Fire and Allied Lines	$5,447,423	$5,621,000	$3,214,498
Casualty Lines	613,153	667,100	417,413
Worker's Compensation	2,797,280	2,348,400	1,958,069
Motor Vehicle Lines	515,230	588,200	445,840
Title	84,206	142,420*	148,594
Prepaid Legal Services Corporations	1,030	1,000	4,635
Burial Associations	428	10,605	957
Aircraft Insurance	-0-	-0-	-0-
TOTAL	$9,458,570	$9,378,725	$6,190,006

*Revenues from title agents licenses also deposited to this fund and expenditures include funds from this source.

The review indicated that maintenance taxes are not currently charged for four lines of insurance which are regulated by the board: life insurance, health maintenance organizations, accident and health insurance and credit insurance. While proportionately more of the agency's expenditures are associated with the regulation of property and casualty insurance, the agency did expend approximately $2,540,000 in fiscal year 1981 for the regulation of insurance lines which do not pay maintenance taxes. Some of these costs would be offset by fee revenues totaling $1,740,000, however it is estimated that approximately $800,000 in costs were paid by property and casualty companies. In order to ensure that all of the major lines of insurance bear a proportionate share of the cost of regulation, the Texas Insurance Code should be amended to assess a maintenance tax for the support of the agency based on the gross premiums written by all companies writing life, accident, health and credit insurance and on the gross revenues received by health maintenance organizations.

Management of Agency Funds. Funds for the operation of the agency are derived from maintenance taxes based on the taxable gross premiums of insurance companies, fees for other regulatory activities carried out by the agency including the licensing and examination of individuals and companies, as well as other authorized charges. Revenues from these fees and taxes are deposited into 21 special funds. Exhibit 2 indicates the types of revenues that flow into each of these funds.

Many of the maintenance tax and fee statutes date back to a time when the various lines of insurance were administered through separate and district statutes and agency divisions. Most of these distinctions have faded over time and many operations are now consolidated. This makes the job of alignment of expenses among the funds a complex mathematical process, especially as the number of funds continues to grow.

Funds for the operation of the agency must be transferred from each special fund to the Insurance Operating Fund No. 36 at the beginning of each fiscal year. At the end of the year the agency allocates the costs of each of the activities supported by these funds to the amount transferred into fund no. 36 from the respective special fund. Any unexpended balances are then transferred back to the appropriate special fund.

The difficulties that arise from manipulating the large number of special funds can be seen by examining what the agency does in instances where not

EXHIBIT 2

Board of Insurance Revenue Distribution
Fiscal Year 1981

Fund No.	Fund Name	Professional Fees	Maintenance Tax	Insurance Company Fees	Licenses	Miscellaneous Fees	Examination and Audit Fees
10	Motor Vehicle Insurance	$	$ 515,230	$	$	$	$
13	Fire Insurance		5,447,423				
14	Compensation Insurance		2,797,280				
54	Insurance Examination						4,189,260
85	Insurance Agent License				1,784,704		
93	Managing General Agents				7,134		
103	Credit Insurance			96,001			
110	Fire Extinguisher	35,120					
113	Mutual Assessment	999					
115	Insurance Fee					1,645,636	
119	Fire Works License	53,664					
124	Local Recording Agent				369,541		
161	Casualty Insurance		613,153				
162	Title Insurance		84,026		59,749		
178	Aircraft Insurance						
179	Insurance Premium Finance			64,099			
180	Burial Association Rate		428				
181	Fire Alarm Detection	42,490					
182	HMO				1,497		
183	Prepaid Legal		1,030		3,104		
184	Insurance Adjusters				169,540		
	TOTAL	**$132,273**	**$9,458,570**	**$160,100**	**$2,395,269**	**$1,645,636**	**$4,189,260**

enough funds were transferred into fund no. 36 to cover the costs of regulating a particular activity. The review indicated that instead of transferring additional revenues from the special fund into the operating fund to cover the deficit, the agency made up the difference from activities with unexpended balances. In 1981, in every instance where insufficient funds had been deposited to the general operating fund there were sufficient revenues remaining in the special fund to cover all or part of the shortfall. This practice appears to be in violation of the intent of many of the provisions in the Insurance Code which authorize the collection of these fees and taxes for specific purposes and may result in certain rates and fees being set higher than necessary as a result of having to support activities with insufficient revenues. The management of agency funds would be much less complex and costs could be allocated more accurately if all revenues dedicated to the support of the State Board of Insurance were deposited to the agency's general operating fund and the agency used cost accounting procedures to establish the appropriate rate for each of fees or taxes levied.

Need to Reduce Fund Balances. Since, historically, fee and tax revenues deposited to a number of the agency's special funds have exceeded the appropriations to the State Board of Insurance, large balances accumulated in some of these funds. The year-end balances in all special funds totaled $10.7 million in 1979, $12.9 million in 1980, $13.9 million in 1981 and $13.7 million in 1982. In performance evaluation reports to the 66th and 67th Legislatures, the Legislative Budget Board expressed concern about the size of these balances and recommended the inclusion of a rider in the General Appropriations Act which directs the agency to limit the cash balances in the special funds to 60 percent of the agency's appropriations for the 1983 fiscal year. In order to determine the agency's progress in meeting this provision a comparison was made between the maximum amounts that should be in the funds at the end of the 1982-83 biennium and the balances in these funds as of August 31, 1982. The results, shown in Exhibit 3, indicate that the balances totaled 75 percent of the agency's appropriations for 1983. The review indicated that at least part of the problem in meeting the 60 percent limitation is due to a lack of flexibility to adjust the revenue rates in most of the funds. Exhibit 3 also indicates that while the board can adjust the tax or fee rate deposited to four funds; there is no flexibility possible in most of the remaining funds. As a result 62 percent of the balances in excess of the 60 percent limitation occur in funds where no adjustments can be made. However one instance was

EXHIBIT 3

Fund	Balance 8/31/82	Amount in Excess of 60% Limitation	Authority to Adjust Assessment or Fee
Motor Vehicle Insurance	$ 402,979	$ 9,252	No
Fire Insurance	5,327,884	1,188,576	Yes
Compensation Insurance	2,008,666	330,723	No
Insurance Examination	2,551,062	112,111	Yes
Insurance Agents License	-0-	N.A.	U.B. to Insurance Examination
Managing General Agents	3,552	-0-	No
Credit Insurance	60,855	-0-	No
Fire Extinquisher	58,649	6,701	No
Mutual Assessment	1,119	530	No
Insurance Fee	1,882,495	1,634,723	No
Fireworks License	35,592	16,176	U.B. to General Revenue Fund
Local Recording Agent	464,692	196,049	No
Casualty Insurance	567,135	84,801	Yes
Title Insurance	149,054	65,542	No
Aircraft Insurance	-0-	-0-	Yes
Insurance Premium Finance	28,566	515	No
Burial Association Rate	148	-0-	No
Fire Alarm Detection System	93,493	59,531	No
HMO	1,548	-0-	No
Prepaid Legal Services	1,916	1,485	No
Insurance Adjusters	100,846	-0-	No
TOTAL	$13,740,269	$3,706,715	

noted where the board does have the flexibility to adjust the rate where the balance equals 77 percent of the 1983 appropriation. Amending the Insurance Code to permit the board to adjust the various assessments and fees deposited to the agency's special funds within statutorily established limits would assist the board in minimizing fund balances and result in greater consistency in the treatment of agency revenues. Where the board already has the flexibility to adjust rates, the agency should take steps to reduce fund balances to meet the 60 percent rider limitation in the Appropriations Act.

Inconsistencies in the treatment of similar revenues. With two exceptions all fees connected with the regulation of companies by the State Board of Insurance are deposited to the appropriate special fund to offset the costs of regulation. Since the statutes governing the regulation of health maintenance organizations and prepaid legal services corporations do not specify a designated fund for the deposit of application and filing fees, these fees which totaled $1,675 in 1981 are deposited to the General Revenue Fund while fees for licensing agents for these two types of companies are deposited to the special funds established for the regulation of these entities. In the case of the regulation of health maintenance organizations depositing these revenues into the appropriate special fund would have at least partially offset a $91,000 deficit that had to be absorbed by other funds dedicated to the agency's support.

Another inconsistency in the handling of fee revenues results from the statutory requirement that the balances in the Fireworks Licensing Fund revert to the General Revenue Fund at the end of each fiscal year instead of being retained for the administration of the fireworks licensing act. Approximately $53,000 was transferred to the General Revenue Fund at the end of 1981 as a result of this provision.

Finally, the Insurance Code provides that the balances in the Agents Licensing Fund No. 85 be transferred to the Examination Fund No. 54 at the end of each biennium. At the end of the 1980-81 biennium approximately $1.4 million was transferred under this provision. The Insurance Code should be amended to: 1) deposit all the fees connected with the regulation of health maintenance organizations and prepaid legal services corporations to the appropriate special funds; and 2) permit ending balances in the Fireworks Licensing Fund and the Agents Licensing Fund to be retained in the appropriate special fund for the administration of the applicable statutes in order to provide for consistency in the treatment of

similar types of revenues and to ensure that the revenues generated by these fees are used to support the related costs of regulation.

Evaluation of Programs

The programs of the State Board of Insurance are divided into four functional areas for the purposes of evaluation: licensing, compliance, enforcement and ratemaking. A description of the activities within each of these functional areas as well as any significant problems identified in the review are covered in the material which follows.

Licensing

A major statutory responsibility related to the regulation of insurance is the licensing of qualified insurance companies, agents, adjusters, certain fire protection industries, premium finance companies, health maintenance organizations and pre-paid legal services corporations to do business in Texas. These licensing activities are carried out primarily through three agency programs: the State Fire Marshal's Office, the Financial Monitoring Program, and the Business Practices Program.

The Texas Insurance Code authorizes the issuance of 16 different types of licenses to individuals who act as agents for various types of insurance companies. The qualifications and requirements for the licenses generally include sponsorship by a company, and good character and references. Most licenses require passing an examination. Some types of licenses also require completion of additional educational requirements and evidence of financial responsibility or experience.

Under the Insurance Code, insurance companies are also required to meet specific statutory requirements in order to be licensed to do business in Texas. The statutory criteria which must be considered in determining whether to license a company include: 1) whether the proposed capital structure meets minimum statutory requirements; 2) whether the proposed officers and directors have sufficient insurance experience ability, standing and good record to render the success of the proposed company probable; and 3) whether the applicants are acting in good faith. In instances where the company is incorporated under the laws of any other state or country the company must also furnish the board with information concerning the financial condition and operational history of the company. Insurance companies licensed by the board include life companies, fire and casualty companies, lloyds, fraternal benefit companies, stipulated premium companies, mexican casualty companies, title insurance companies, mutual assess-

ment companies such as burial associations, county mutuals, farm mutuals, health maintenance organizations, reciprocal exchanges, premium finance companies and non-profit prepaid legal corporations.

In addition, the fire marshal's office is also responsible for certifying companies and licensing individuals engaged in the following occupations: 1) installing or servicing portable or fixed fire extinquisher systems; 2) selling, servicing or maintaining fire alarm or fire detection devices; and 3) manufacturing, distributing, selling at retail or importing fireworks for sale in Texas.

In any licensing process the agency must first make the initial determination of competence. Once the license or certificate is issued, a renewal process should be in place when necessary to keep the system current. The evaluation of the agency's licensing processes focused on whether the determination of competence is based on qualifications which are clear, easily determined, and reasonably related to practice; whether these qualifications include an evaluation which accurately and fairly determines competence; whether processing procedures are designed to handle applications in a reasonable amount of time and whether the renewal process is appropriate. The review indicated that the agency licenses a large number of companies and individuals in a generally efficient and effective manner; however, several areas were identified where the licensing function could be improved.

Licensing Examination Alternatives. Currently, the Texas Insurance Code requires applicants seeking any one of 10 different licenses to pass a written examination administered by the board which has authority to prescribe the scope, type and conduct of the examination. Exhibit 4 indicates the licenses which require written examinations, the number administered during 1981 and the percentage passing for each. Licenses which do not require passing a qualifying examination include title agents, escrow officers, state, special or salaried representatives, surplus lines agents, and non-resident fire and casualty agents. The review indicated that in some instances there was an alternative to examinations developed and administered by the board.

A division of the Educational Testing Service (ETS) has developed and administers licensing examinations for the four major lines of insurance: life, accident and health, property and casualty. ETS currently offers these examinations on 24 dates per year at more than 100 test sites in 18 states and jurisdictions. Each test has two major parts: one part contains questions covering basic

Exhibit 4

LICENSING EXAMINATIONS ADMINISTERED
Fiscal Year 1981

License	Statutory Reference Texas Insurance Code	Examinations Administered	Percentage Passing
Life - Group I	21.07-1	15,536	53
Accident and Health-Group II	21.07	338	96
Fire & Casualty	21.14	5,890	52
Variable Annuity	3.72	405	96
Variable Life	3.73	186	58
Managing General Agents	21.07-3	77	78
Adjuster	21.07-4	178	62
Prepaid Legal Services	23	159	45
H.M.O.	20A	33	88
Counselor	21.07-2	45	49

principles of insurance and product knowledge common to all states; and a second part, developed by a committee of insurance professionals selected by the Commissioner of Insurance in each participating state, contains questions covering the laws, rules, and regulations unique to each jurisdiction. Services provided by ETS include: 1) development of the tests; 2) provision of all materials including test booklets and answer sheets; 3) processing of all applications for examinations; 4) maintenance of test centers staffed by test administrators and proctors; 5) provision of special testing arrangements for handicapped candidates; and 6) grading and reporting of examination results to both the candidates and the department.

However, the review indicated that although the use of a national examination is a viable alternative to examinations developed by the board the agency indicates that a number of statutory changes would be necessary to permit the board to consider the use of such an examination. Article 21.07 of the Insurance Code currently provides that any insurance carrier is permitted to conduct written examinations for its agents under that statute. The agency indicates that no company has applied to conduct examinations under this provision but that some might apply if the ETS program were adopted. The results of the review indicated that this provision should be eliminated on the grounds that adequate test security can not be ensured under this provision for either board-developed or national examinations. This same article also grants every applicant the authority to take the examination at least once a month in the county courthouse of the residence of the applicant. Since the costs of complying with this requirement would be prohibitive for both the agency and any outside testing service, the Code should be amended to eliminate this provision. Other statutory changes which might be required in order to provide the board with the option to use a national exam include: 1) amending language which requires the board to conduct examinations; 2) modifying provisions concerning advisory boards authorized in the licensing statutes; and 3) clarifying language regarding the purposes and uses of fees.

Since state regulatory boards such as the State Board of Insurance which use locally prepared examinations face difficulties in substantiating the job relatedness, validity and non-discriminatory nature of their examination process, the review indicated that amending the Insurance Code to remove any statutory impediments to the use of a national examination would improve the effectiveness of the licensing process.

Minimum Capital and Surplus Requirements. Minimum capital and surplus requirements provide one of the most important ways of providing solidity for insurance companies. These requirements provide the cushion of safety to absorb fluctuations in the value of assets and liabilities as well as unexpected losses and expenses. The minimum capital and surplus requirements in Texas, shown in Exhibit 5, are currently the lowest in the United States. The only significant change in these requirements since 1909, when they originally established, occurred in 1955 when additional surplus requirements were added. Although the low level of capital and surplus cannot be associated with a relatively high rate of insolvencies, it does appear to have contributed, at least in part, to the unusually large number of domestic companies licensed to do business in Texas. Since the current premium tax rate structure in Texas gives a decided advantage to doemestic companies (1.1 percent versus 3.5 percent) the low capital and surplus requirements provide an incentive for parent companies to form domestic subsidiaries to write insurance in Texas which may then be reinsured with the parent company. To the extent that this process takes place gross premium tax revenues to the state are reduced since the insurance written by the domestic subsidiary is taxed at a much lower rate than if the parent had written the insurance as a foreign insuror.

The review also indicated that, unlike chartering requirements for other financial institutions in Texas such as banks and savings and loans, where the most recent trend has been to give the commissioner the authority to establish minimum capital and surplus requirements for financial institutions chartered in this state, the minimum capital and surplus requirements for insurance companies are specified in statute. In order to provide the board with flexibility to adjust minimum capital and surplus requirements to provide for the needs of the proposed company and to protect the public from insolvencies, the Texas Insurance Code should be amended to provide the board with the authority to set the initial capital and surplus requirements based on the number and types of insurance lines written, the general economic situation, as well as any other factors relevant to the company's need for capital and surplus.

Simplifying the Chartering Process. A comparison of the chartering procedures of fire and casualty companies and life, accident and health companies indicated that the chartering process for life, accident, and health companies was unnecessarily complicated. In the case of an application for a charter as a fire and

casualty company once the paperwork has been reviewed by the staff and any deficiencies resolved, an examiner is assigned to make a qualifying examination of the company. After the examination report is completed the applicant is advised by letter as to the date of the original incorporation hearing and the text of the newspaper notice to be published in a daily newspaper in the state. At the incorporation hearing the management and principal owners of the proposed company testify as to the plans, goals, and long-term objectives of the company; the insurance experience and ability of the proposed officers, directors and managing executives of the company; as well as providing testimony concerning who will be charged with the day-to-day operations of the company, who will supervise agents, and who will be in charge of underwriting. When an application is approved by the commissioner, the incorporation papers and the Commissioner's Order are sent to the Attorney General for review and approval. After the charter is returned from the Attorney General's office, a certified copy is sent to the company which then may issue its stock to subscribers, hold an initial Board of Director's meeting, elect its officers and adopt company by-laws. Once the company has taken these actions and deposited $50,000 in cash or specified securities with the State Treasurer, a certificate of authority is issued to the company and it is considered to be a licensed insurer with the power to appoint agents and transact business.

The process for approving a charter application for life, accident and health companies is somewhat similar except that the qualifying examination conducted by agency examiners is made subsequent to the initial incorporation hearing and approval by the commissioner. As a result, a second hearing must be scheduled to make the examination report a part of the record and to ascertain whether the facts and representations made at the first hearing are still correct before a Certificate of Authority can be issued and the company considered to be licensed to do business. Agency staff could not identify any substantive reason to continue to require two hearings for life companies and one hearing for casualty companies as long as the qualifying examination of the life, accident and health company is conducted prior to the incorporation hearing. Amending the statute to remove this requirement will result in savings to both the agency and the applicant.

The agency could also not identify any reason to continue to require the Attorney General to review and approve the documents connected with charter applications. A review of the statutes governing the chartering procedures for

Exhibit 5

Minimum Capital and Surplus Requirements in Selected States

STATE	PAID UP CAPITAL	SURPLUS
Alabama	$ 800,000	$800,000 - 1,200,000
Alaska	$ 750,000	$ 750,000
Arizona	$ 400,000 - 500,000	$200,000 - 1,000,000
Arkansas	$ 500,000	$ 500,000
California	$ 1,000,000	$ 1,200,000
Colorado	$ 1,250,000	$ 750,000
Connecticut	$1,000,000 - 2,000,000	$ 2,000,000
Delaware	$ 500,000	$ 250,000
Florida	$ 500,000	1,000,000
Georgia	$ 200,000	$ 200,000
Illinois	$ 750,000	$ 500,000
Iowa	$ 1,000,000	$ 1,000,000
Kansas	$ 300,000	$ 300,000
Kentucky	$ 150,000 - 600,000	$ 225,000 - 900,000
Maine	$ 1,000,000	$ 1,000,000
Maryland	$ 250,000 - 500,000	150% of minimum capital required
Massachusetts	$ 100,000 - 500,000	$200,000 - 1,000,000
Michigan	$ 1,000,000	$ 500,000
Minnesota	$ 1,000,000	$ 2,000,000
Missouri	$ 800,000	$ 800,000

STATE	PAID UP CAPITAL	SURPLUS
Montana	$200,000 - 1,000,000	50-100% of minimum capital required
Nebraska	$ 500,000	$ 500,000
Nevada	$ 100,000 - 500,000	$250,000 - 1,000,000
New Hampshire	$ 800,000	$ 200,000
New Jersey	$ 1,500,000	$ 2,850,000
New Mexico	$ 200,000	$ 100,000
New York	$200,000 - 2,000,000	$100,000 - 4,000,000
North Carolina	$600,000 - 1,800,000	$900,000 - 2,700,000
North Dakota	$ 500,000	$ 500,000
Ohio	$ 1,000,000	$ 1,000,000
Rhode Island	$ 200,000	$ 800,000
South Carolina	$ 150,000 - 375,000	$ 150,000 - 375,000
Tennessee	$ 750,000	$ 375,000
Texas	$ 100,000 - 200,000	$ 50,000 - 100,000
Utah	$ 200,000 - 400,000	$ 450,000 - 600,000
Virginia	$ 1,000,000	$ 1,000,000
Wisconsin	$200,000 - 2,000,000	50% of minimum capital required
Wyoming	$ 200,000 - 750,000	$ 150,000 - 500,000

banks, savings and loans and credit unions could not identify any other instance where similar documents required the review and approval of the Attorney General. The agency currently has its own legal staff that could review incorporation papers, company charters and commissioner's orders whenever necessary.

Charges for the Examination of Companies. The Texas Insurance Code authorizes the agency to charge domestic insurance companies for costs incurred in the periodic examination of companies. Companies which are examined are charged a fee based on the actual expense of the examiners. In addition, all companies are charged an annual assessment to fund all overhead costs connected with the examination of companies not calculated in the examination fee. The Code provides that all examination fees and assessments paid may be credited to the amount of premium taxes owed by the company. As a result of this offset provision the review indicated that the burden of examination costs falls primarily on the smaller companies who pay little or no premium tax while the entire cost of the examination of larger companies is borne by the state. In fiscal year 1981, the total cost of the examination program was $5.7 million. Of this total 318 companies were able to credit the full costs of their examinations, totalling $4.9 million, against their premium tax liability. However, approximately 116 companies who paid no premium taxes because they wrote no direct premiums or who wrote only first year premiums which are not taxable and 81 companies whose examination and assessment fees exceeded their premium tax liability were required to pay more than $768,000. In addition, the agency's examination staff indicated that since larger companies do not have to pay any of the costs associated with an examination, there was no incentive for the company to provide their fullest cooperation in order to minimize agency time and costs. In order to assure greater equity among all companies and to provide additional incentives to expedite the examination process all companies should be charged the actual costs of examinations plus any assessment for overhead with no offset provided against their premium tax liability.

Compliance

The State Board of Insurance performs a number of routine inspections, audits, examinations, and other monitoring activities which are designed to ensure compliance with the Insurance Code and the rules and regulations promugated by the board. These monitoring activities are a part of the regulatory activities in

four agency programs: financial monitoring, business practices, the commissioner's office, and the state fire marshal's office.

The Texas Insurance Code requires that all domestic insurance companies be examined once each six months for the first three years after organization, once each year for the second three years, and once every three years thereafter in order to detect problems in time to take corrective action to prevent insolvencies. Board staff also participate in examinations of out-of-state domiciled companies licensed to transact business in Texas. By examination of companies the board determines company financial strength; the extent to which financial transactions have been authorized by proper company authority; and the extent of company compliance with statutes and regulations in its investment of company funds, in selling policies, in dealing with its policy holders, and in maintaining adequate organizational and financial records.

The board's actuarial staff also participates in company examinations by reviewing the reserve liabilities and other actuarial matters at the home offices of domestic companies in connection with the agency's field examinations. In addition, the actuarial staff audits annual valuation reports of reserve liabilities filed by legal reserve and stipulated premium companies and reviews the actuarial statements which are attached to the annual statements.

In addition to monitoring companies through on-site examinations agency staff review financial statements submitted by the companies on an annual basis. These statements are reviewed for financial solvency, proper accounting practices and compliance with reserve and investment laws. The agency also reviews insurer's annual tax returns for completeness and accuracy and collects all fees and taxes due.

The Insurance Code requires that all domestic insurers that are members of a holding company system file an annual registration statement for review by the agency which discloses information about the business relationships, transactions and agreements between the insurer and the holding company. In addition the agency reviews insider trading reports submitted by officers, directors and major shareholders of insurers with at least 100 shareholders to prevent these individuals from unfairly using inside information to receive personal profits on the purchase and sale of equity securities in an insurance company.

Inspection activities related to compliance are performed by a staff of inspectors in the State Fire Marshal's Office who inspect mercantile,

manufacturing and public buildings to determine if there are fire hazards, and other conditions which would endanger the occupants or firemen. These inspectors also inspect fireworks stands during selling seasons to determine compliance with statutory requirements. Retail service stations are inspected in response to complaints concerning the safe storage, handling, and use of flammable liquids.

The evaluation of these compliance activities included a review of: 1) whether the monitoring activities were conducted as frequently as necessary to ensure compliance; 2) whether the procedures used to perform monitoring activities were systematic and uniform; 3) whether the scope of the examination was broad enough to ensure compliance; and 4) whether the fees charged for these activities were reasonable. Finally, the agency's use of information gained during its monitoring activities was examined to determine whether audit results were reported to the proper individuals both within the agency and without, and whether a procedure existed for follow-up of violations discovered during the process. The results of the review indicated that the scheduling, performance and use of the results of the agency's compliance activities were generally satisfactory; however, several concerns involving the collection of gross premium taxes are discussed below.

Quarterly Payments of Premium Taxes. All of the 50 states, including Texas impose an insurance premium tax based on a fixed percentage of gross premium receipts on either domestic companies, foreign companies or both. The Texas Insurance Code currently requires premium taxes to be paid on or before March 1 for the preceding calendar year except for foreign and domestic life, health and accident companies which are due by March 15. However, the review indicated that at least 21 other states including New York, California and Illinois require insurance companies to remit insurance premium taxes more frequently than once a year. In addition, the results of the review indicated that a number of other taxes in Texas including the sales tax, the gas, electric and water utility tax, the gas utility administration tax, and oil and gas production taxes are paid more frequently than once a year. The volume of insurance sold in Texas and the resulting tax revenues have increased substantially as shown in the following page.

Year	Amount	
1979	$156,880,591	
1980	$163,926,019	
1981	$173,774,281	
1982	$185,000,000	(est.)
1983	$195,000,000	(est.)

It is estimated that if there had been quarterly pre-payments of the gross premium taxes in fiscal year 1982, the additional annual interest rate earned by the state would have been approximately $8.1 million. The agency estimates the additional costs associated with quarterly collections to be $50,000. Amending the Texas Insurance Code to require quarterly pre-payments of gross premium taxes for all companies paying more than $1,000 in taxes would result in substantial additional interest revenues to the state, and assist the state's cash management program by distributing a major revenue source more evenly throughout the year.

Statute of Limitations on Gross Premium Tax Receipts. The review indicated that there is currently no statute of limitation on the gross premium taxes paid by domestic or foreign life, accident and health organizations. A review of the statutes related to other state taxes collected by the comptroller including sales taxes, franchise taxes, motor fuel taxes and oil and gas production taxes as well as premium taxes from other lines of insurance indicate that all have a four year statute of limitation. The absence of this limitation is especially important in the case of life, accident health premium taxes since more than $27 million has been paid in protest pending the outcome of suits alleging the current rate structure is discriminatory to foreign insurers. Without a statute of limitation there would be no limit on the state's potential liability if the court ruled the tax was discriminatory. In order to limit the potential liability from these suits, the Texas Insurance Code and Articles 4769 and 4769a, V.A.C.S. should be amended to provide a four year statute of limitation for life, accident, and health premiums comparable to that provided for the payment of gross premium taxes on fire and casualty lines of insurance.

Audits of Premium Tax Payments. Currently, the agency's audit of gross premium tax statements submitted by insurance companies is limited to a review

for completeness and numerical accuracy. Tax credits claimed for examination and valuation fees and assessments are verified against the agency's records but no on-site audits of premium taxes and related items are performed at the offices of selected companies in order to validate the amounts reported by the companies or to verify that certain amounts have been properly determined. The State Comptroller's Office currently employs 467 field auditors who perform this type of audit at both in-state and out-of-state locations in connection with the collection of approximately 26 different classes of tax revenues totalling $7.7 billion and reports an average of $274 million in additional tax collections each year as a result. Based on these figures it is anticipated that conducting field audits to verify gross premium tax collections could result in approximately $10 million in additional annual revenue to the General Revenue Fund as well as resulting in greater reliability in the amounts reported and compliance with the insurance taxing statutes. The review indicated that these audits could be performed either by providing the State Board of Insurance with additional staff to perform this function or by assigning responsibility for these audits to the Comptroller's Office which already provides this service to the Public Utility Commission and the Railroad Commission as well as 973 municipalities and two mass transit authorities.

Rate-making

The price of insurance is controlled to varying degrees in Texas depending on the line of insurance or the type of insurer. With the exception of credit life insurance, life insurance regulation does not encompass the setting of rates, except in a very general way. The state does regulate the establishment of adequate reserves which implies that rates must be sufficient to maintain such reserves; however, a company still retains considerable flexibility in determining the rate levels and structure. In property and casualty lines of insurance the rate regulation is more direct with the board either promulgating rates in lines such as automobile title, workers' compensation, and fire and extended coverage or requiring prior approval of rates filed for lines of insurance such as bond, burglary and other miscellaneous casualty lines.

In developing rates the board utilizes a total rate of return concept where a target fair rate of return is determined. This rate of return considers income from all sources prior to establishing a profit allowance in the formula for profit from

selling and servicing insurance policies. The board currently uses 5.75 percent of mean admitted assets as the targeted rate of return on all lines of insurance.

The main factors affecting property and casualty rates are changes in claim costs, claim frequencies and insured values. Since 1979, claims costs have generally risen rapidly due to the effects of inflation. In some lines changes in claim frequencies and insured values have acted to offset increasing claim costs. In title insurance, increasing insured values have held increasing costs in check, resulting in an average annual rate increase of 5.1 percent since 1979. In automobile insurance large increases in average claim costs have overshadowed reductions in claim frequencies to produce average annual rate changes of +9.8 percent for private passenger risks and +1.7 percent for commercial risks. In some instances such as workers compensation insurance, rates have gone up on four occasions and down on three occasions between 1979 and 1982. The net effect is an average change of 2.8 percent. The same situation has occurred in property insurance where rates have gone up on one occasion and down on three others for an average change of -5.2 percent. The direct consideration of investment income produced a 1982 private passenger automobile rate change of +14.8 percent instead of +23.1 percent a property rate change of -16.3 percent instead of -11.7 percent and a workers' compensation rate increase of +7.2 percent instead of +9.7 percent.

The Insurance Code directs the State Board of Insurance to set uniform automobile insurance rates that are "fair and reasonable". All regulated insurance companies are to charge these rates to their policyholders when writing auto insurance policies in Texas. County mutual insurance companies are exempt from board rates, however these companies must use board promulgated forms and file rates for informational purposes.

Every insurer writing any kind of automobile insurance in Texas is required to file with the board annually a report showing their premiums and losses on each classification of motor vehicle risks written in this state. The code directs the board to use this information as well as other relevant factors such as investment income, both within and without the state to determine its rates. To determine what the new rates should be, the State Board of Insurance conducts annual hearings to review rate proposals developed by the board's actuarial staff and the rates developed by the industry bureau, the Texas Automobile Insurance Services Office and to receive any testimony from the general public.

Once the rates are promulgated by the board, insurers seeking to write automobile insurance at rates different from those promulgated by the board make a written application to charge rates higher or lower than the uniform rates. These adjusted rates are called "deviated" rates. The provision for deviated rates recognizes that some companies are better off than the industry as a whole and can sell insurance at lower rates while other companies need higher rates to remain financially solvent. Approximately 56 percent of all private passenger autombile insurance in Texas is written under a downward deviation. Less than 4 percent of all policies are written under upward deviations. In 1973 the legislature provided for additional flexibility in rate setting by permitting the board to approve rates greater than the standard rate or premium promulgated by the board on an individual risk basis provided the person to be insured consents to such a rate.

Title rate-making procedures are different from any other line of insurance. All title insurance companies and all title insurance agents operating in Texas are required to report Texas underwriting and expense experience to the board by May 15 for the preceding calendar year. Title insurance companies also report investment experience, both in Texas and nationwide. However, the importance of the factors considered in rate-making for title insurance is slightly different from other lines of insurance where loss experience is a primary factor in establishing rates. Most of the costs of title insurance goes toward searching the title records to discover any possible defects. If the insurer does this research well, the risk is virtually eliminated. As a result only about 5 to 10 percent of the insurer's gross income is normally used to pay losses on title insurance policies while approximately 80-85 percent of its income is absorbed by operating expenses such as employee salaries, commissions, and the cost of maintaining a title plant. The rates established by the board apply statewide and vary depending on the cost of the transaction. No deviations are permitted.

Factors that determine fire insurance rates and premiums include the materials used to construct a building, the occupancy or use of a building, location of the building, fire hazards present, fire protection systems, the key rate of the city or town where the building is located and the loss experience for that class of building. Changes in premium costs are due primarily to changes in the experience credits and penalties which the board approves annually based on loss experience for the previous five years. Downward deviations on a statewide basis or by reasonable territories are permitted and rates in excess of the maximum rate

promulgated by the board are permitted on specific risks provided the individual insured consents to such a rate. Approximately 50-55 percent of all fire insurance and 85-90 percent of all homeowners insurance in Texas is written under a downward deviation and less than 1 percent is written on the basis of consent to rate.

In establishing rates for workers compensation insurance lines the board considers loss ratios; expenses related to claims, audits, general administration and inspections; an allowance for profit and contingencies; taxes; commissions; and investment income. Each workers' compensation insurer must provide on an annual basis to the board a statistical report for each of its individual policyholders showing the number and type of claims and amounts of losses, payroll and premiums. In addition, companies submit annually, aggregated rate development and financial data. The board promulgates rates for each of 700 individual classifications of hazards with rates ranging from 28 cents for auditors and accoutants to $59.06 for rigging. A rate represents the unit of premium per $100 of payroll of an employer or policyholder. These rates are promulgated annually based on the latest two years loss experience of policyholders taken from the statistical data submitted. This is one of the only lines of insurance where rates are promulgated by the board that the agency gathers its data for rate making directly from the insurers rather than through a rate bureau. Currently, the board employs 11 individuals in the statistical and rate-making section with responsibility for collecting and analyzing data from 280 companies writing worker's compensation insurance. Texas operates under a uniform rate law in worker's compensation and there are no deviations permitted from established manual rates.

The review of the rate-making functions of the board focused on the procedures used to set rates. No recommendations were identifed as a result of this review, however, one alternative concerning the use of the National Council on Compensation Insurance in setting rates for worker's compensation insurance and the issues concerning the consideration of investment income in rate-making are discussed in subsequent sections of this report.

Enforcement

Like most other regulatory agencies the State Board of Insurance has a statutory responsibility to ensure that minimum standards required to receive a license or charter are maintained by persons or organizations while they engage in the regulated activity. In order to enforce the provisions of the Insurance Code the

agency employs a number of field investigators whose efforts are directed to enforcement of the agent's licensing laws. These investigations involve alleged improper acts of insurance agents or persons acting as insurance agents. These investigators also work in conjunction with claims and complaints personnel in conducting examinations of insurers where questionable insurance practices are noted. The Fire Marshal's Office employs investigators to investigate, upon request, any fire to determine the origin, cause and circumstances, and to identify guilty parties, assist in their arrest and prosecution and give court testimony when required.

In the case of individuals licensed by the agency the sanctions generally available to the board include issuance of a cease and desist order, suspension, monetary forfeitures and revocation. In the case of companies regulated by the board if, in the course of an examination, there is evidence that the company is in or moving towards a hazardous position, the agency reviews the problem with the management of the company. If the management chooses to present a plan to resolve the problems identified which meets the board's approval, the agency then monitors the company's progress towards resolving the problem through frequent reporting requirements. If the problems are too serious or the company refuses to take sufficient remedial action, three courses are available: supervision, conservatorship, and receivership. Supervision may be instituted when the commissioner determines that a company is, or appears to be, insolvent or has failed to comply with the law, or when the company gives its consent. From the time of notice of supervision, the company has 60 days to correct the situation. During supervision there are certain restrictions on the company's actions designed to protect its assets. If the conditions are corrected within 60 days, supervision is discontinued; if not, the commissioner may either appoint a conservator who is responsible for the managment and day-to-day operations of the company, or in instances where the company is not in condition to continue business he may notify the Attorney General to apply to district court for the appointment of a receiver.

No recommendations were made as a result of the review of the agency's enforcement activities.

EVALUATION OF OTHER SUNSET CRITERIA

The review of the agency's efforts to comply with overall state policies concerning the manner in which the public is able to participate in the decisions of the agency and whether the agency is fair and impartial in dealing with its employees and the general public is based on criteria contained in the Sunset Act.

The analysis made under these criteria is intended to give answers to the following questions:

1. Does the agency have and use reasonable procedures to inform the public of its activities?
2. Has the agency complied with applicable requirements of both state and federal law concerning equal employment and the rights and privacy of individuals?
3. Has the agency and its officers complied with the regulations regarding conflict of interest?
4. Has the agency complied with the provisions of the Open Meetings and Open Records Act?

EVALUATION OF OTHER SUNSET CRITERIA

The material in this section evaluates the agency's efforts to comply with the general state policies developed to ensure: 1) awareness and understanding necessary to have effective participation by all persons affected by the activities of the agency; and 2) that agency personnel are fair and impartial in their dealing with persons affected by the agency and that the agency deals with its employees in a fair and impartial manner.

Open Meetings/Open Records

Review of the agency's compliance with the Open Meetings Act indicates that the agency has generally made timely filings with the Secretary of State's Office. However, a review of the board minutes did indicate instances where the board has voted on matters in executive session rather than in an open meeting. The Open Meetings Act requires that all final actions, decisions or votes with regard to any matter discussed in a closed meeting shall be discussed in a meeting open to the public. The chairman of the board has indicated that the board will adjust its procedures in order to comply with the provisions of the Act.

The review also indicated that the agency had experienced difficulties in one area as a result of the provisions of the Open Meetings Act: staff conferences to review working papers for major reports. Although the papers reviewed in these meetings are exempted from disclosure under the Open Records Act, these conferences have been routinely posted as open meetings. The only alternative to posting these meetings identified by the agency has been to consult with each board member separately. However, this process is not cost effective and eliminates the free exchange of ideas necessary to develop final report language.

The review of the agency's compliance with the Open Records Act indicated that in preparing the information for a study being conducted on the implementation of the Open Records Act (authorized by S.R. 670, Acts of the 67th Legislature), and the Sunset Commission's self-evaluation report, the agency had identified several problems concerning compliance with the Act. The main problem identified was the lack of consistency in the agency's responses to open records requests due to the decentralization of records within the agency. Since the agency is divided into several programs, which regulate different segments of the industry, records are filed and maintained in the separate divisions. Some divisions also reported difficulties determining whether disclosure of information would give advantage to competitors or bidders or whether the information

maintained related to examination, operating or condition reports for the use of the agency only. The agency determined that this decentralization and the lack of a written procedure for reviewing requests for information, resulted in inconsistent responses to information requests. Since information requests that were denied have generally not been pursued by the requesting party, many of these denials were never reviewed by the legal staff. The review indicated that the agency has taken several steps to address this problem. First, a written procedure for addressing open records requests is being developed. In addition, a list of all files maintained by each division and a list of information considered confidential was prepared and reviewed by the general counsel, the director of legal services, and the chief hearings officer. Items which were found to have been improperly exempted from disclosure were discussed with the manager responsible for those records so that proper disclosure is made on all future requests.

EEOC/Privacy

A review was made to determine the extent of compliance with applicable provisions of both state and federal statutes concerning affirmative action and the rights and privacy of individual employees. During the review, it was noted that the agency's affirmative action plan had not been updated since it was approved in 1974. The agency should take steps to periodically review its progress towards the affirmative action goals established in the plan and update the plan annually. An additional concern noted was the absence of a formal grievance procedure during the period under review. The board has subsequently approved a "provisional" procedure but, it is not included in the agency personnel manual. In order to ensure that employees are fully aware of procedures available for pursuing a complaint, the procedure adopted by the board should be adequately publicized within the agency and made a part of the personnel manual.

Conflicts of Interest

Under state law, appointed state officers are subject to statutory standards of conduct and conflict of interest provisions. This includes, in certain circumstances, the filing of financial disclosure statements with the Office of Secretary of State. A review of the documents filed with the Secretary of State indicate that all board members have filed the required financial statements. the review also showed that the agency has procedures for making employees aware of their responsibilities under the states' conflict of interest statutes. All new

employees are asked to sign an affidavit indicating that they have read and will comply with these statutes.

Public Participation

In general, the review of public participation consists of an evaluation of the extent to which persons served by the department and the general public have been informed of agency activities and the extent to which the agency is responsive to the changing demands and needs of the public. The review indicated that the agency defines the term "public" to include private citizens, representatives of public interest groups, public officials and those citizens or representatives of organizations with substantial economic interests in the actions of the board. While most agency publications are directed to the individuals or industries regulated by the board, the board attempts to encourage public participation through the scheduling of annual single subject hearings for automobile, home-owners and other lines of insurance where there is general public interest so that all individuals and groups can present their views. In addition, board members are active in speaking to groups and media representatives statewide.

However, a survey of the public information activities in a number of other states indicated that in at least 33 states, one of the ways insurance departments have fulfilled their mandates to protect the consumer is through consumer education. Of the 15 states contacted directly during the review, 13 published pamphlets, buyer's guides or bulletins directed at the consumer. These publications primarily provide information on personal lines of insurance such as automobile, homeowners, and life and health insurance. Typically, these guides attempt to inform the consumer by describing the nature of the product, delineating some key questions a purchaser should consider when seeking coverage, and informing consumers of their rights and/or telling them how to resolve complaints.

In order for there to be a truly competitive market for insurance, both buyers and sellers need to have adequate information in order to make informed decisions. Most of the published research in this area, the results of a study conducted by the State Board of Insurance on the insurance problems of the elderly and the handicapped, and a review of the complaints filed by consumers with the State Board of Insurance, indicated a low degree of consumer awareness of exists regarding competing policies, prices and services rendered by different insurers. Reliance on agents to provide this type of information to consumers may not be sufficient since an agent which writes for more than one company must consider

commission scales, volume of business and loss experience under its various agency agreements and contingency contracts in placing business with the companies it represents. Such factors are not necessarily related to ensuring that consumers obtain the lowest price possible commensurate with the quality, type, and amounts of insurance sought.

The review indicated that this type of information would be particularly useful for "essential" lines of insurance such as automobile where all drivers are required to buy insurance and may be unaware of the fact that in Texas although the board regulates automobile insurance rates, automobile insurance may be written at 1) the manual rate; 2) at a rate which deviates some percentage above or below the manual rates, depending on the class or coverage and the company writing the policy; 3) at rates which are not regulated because of the type of company writing the policy; or 4) at a rate higher than the promulgated rates based on the individual's consent. Distribution strategies for this material differ from state to state, however, it would appear that the most effective means of distributing this kind of information would be to require that it be provided by the companies and agents.

Another method employed by to assist the general public is the use of a toll-free consumer WATS line. A review of other state agencies in Texas indicated that toll-free lines are maintained by 15 agencies, including the Blind Commission, Department of Community Affairs, Comptroller of Public Accounts, Governor's Office, the Health Department, Department of Human Resources, Texas State Library, Secretary of State and the State Bar. These WATS lines are generally used to accept complaints, provide information and answer inquiries. Information available concerning toll-free lines maintained by other state insurance departments indicated that staffing ranged from one to four employees and some states logged more than 15,000 calls annually.

The results of the review indicated that although the board informs the public of agency activities, the visibility of the agency could be increased and a greater number of consumers could be served by the publication of consumer-oriented publications and the installation of a toll-free WATS line.

NEED TO CONTINUE AGENCY FUNCTIONS

AND

ALTERNATIVES

The analysis of the need to continue the functions of the agency and whether there are practical alternatives to either the functions or the organizational structure are based on criteria contained in the Sunset Act.

The analysis of need is directed toward the answers to the following questions:

1. Do the conditions which required state action still exist and are they serious enough to call for continued action on the part of the state?
2. Is the current organizational structure the only way to perform the functions?

The analysis of alternatives is directed toward the answers to the following questions:

1. Are there other suitable ways to perform the functions which are less restrictive or which can deliver the same type of service?
2. Are there other practical organizational approaches available through consolidation or reorganization?

NEED

The analysis of need and alternatives is divided into: 1) a general discussion of whether there is a continuing need for the functions performed and the organizational setting used to perform the function; and 2) a specific discussion of practical alternatives to the present method of performing the function or the present organizational structure.

Functions and Agency

The stated objective of the State Board of Insurance is to enforce the laws of this state governing the insurance industry and certain fire protection industries in order to protect the best interests of the public. The protection of the public involves three main goals. The first is to assure the solvency of insurance companies so that future claims can be met. The second goal is that rates be neither excessive, inadequate, nor unfairly discriminatory. Finally, there should be a market available for those who need insurance and can reasonably qualify for it. The need for regulation of insurance was first recognized in Texas as early as 1874 and the body of laws governing the industry has grown steadily since that time.

One of the most compelling reasons for insurance regulation is that an insurance policy is a contract for future services. In most other transactions, the long-term financial viability of the seller is of no concern to the consumer; however, in insurance the assurance of the future solvency of the company is essential to the continued functioning of the industry. While theoretically, the assurance of solvency is possible through self-regulation, the federal government has determined that the interests of the industry, and consumers in sharing risks and spreading the costs of loss are compelling enough to warrant regulation by all the states. Another characteristic of the insurance industry that necessitates regulatory intervention is the lack of adequate consumer information about: 1) the financial condition of an insurance company; 2) meaningful ways to compare the monetary value of insurance policies; and 3) the quality of service purchased.

The conditions creating the original need for enactment of regulatory legislation in 1874 continue in effect today. In addition, under the McCarran-Ferguson Act of 1945 the business of insurance is exempt from federal regulation to the extent that it is regulated by the states. Proponents of the retention of state regulation point to the responsiveness of regulation at the state level to local conditions and the ability and freedom of the various states to innovate, experiment or adapt regulatory strategies which are appropriate for that region's

needs, problems, population or policies. These facts indicate the continuing need for regulation of insurance by the state in Texas.

Continuation of the State Board of Insurance as the agency responsible for the regulation of the insurance industry is also a reasonable approach. There is no state agency with similar regulatory responsibilities and the transfer of these functions to an agency with extensive regulatory functions in areas other than insurance regulation would not appear to offer any substantial advantages. As a result of these findings, no alternative to the current approach for carrying out the regulatory functions of the State Board of Insurance were identified for recommendation; however, several alternatives to the agency's current procedures were identified and are discussed in the following section.

ALTERNATIVES

Change in the Methods of Regulation

Transfer the authority for administration of the Residential Service Company Act to the State Board of Insurance. The Residential Service Company Act, enacted by the 66th Legislature, provides for the licensing and regulation of service companies who undertake, for a specified period of time, to maintain, repair or replace all or any part of the structural components, appliances, or electrical, plumbing, heating, cooling or air-conditioning systems of residential property. Rather than authorize residential service contracts as a new form of insurance product, the bill specifically exempts contracts issued by these companies from insurance regulation and creates a new form of company to issue such contracts. As the bill was originally introduced, the regulation of these contracts would have been assigned to the State Board of Insurance. Responsibility for the regulation of these companies was finally assigned to the Texas Real Estate Commission based on testimony from the Texas Association of Realtors over concerns that this product not be confused with insurance products such as home warranties and over the fact that this product is marketed primarily by real estate sales people.

The legislation provided that a residential service company shall maintain a funded reserve for its liability to furnish repairs and replacement services under its issued and outstanding contracts. It further provides for the submission of annual reports and for examinations of the service company. However, the review indicated that the Real Estate Commission has no actuarial staff to determine whether these companies have set up proper reserves so that future obligations under the contracts issued can be paid. In addition, the commission has no staff trained to perform financial examinations. There are presently ten service companies licensed under this Act. One company with 22,000 outstanding contracts was in serious financial difficulties before its liabilities were assumed by another company. Transferring the administration of this Act to the State Board of Insurance which has the necessary actuarial and financial expertise and performs similar functions for similar types of companies would provide greater assurance to the general public that these companies are adequately supervised.

Elimination of first-year premium tax exemption on domestic and foreign life, health, and accident insurance companies. Currently, all first-year premiums on domestic and foreign life, health and accident insurance policies are exempted

from gross premium taxes. A review of premium tax examptions in other states did not identify any other instances where first-year premiums for any line of insurance were exempt from taxation. Based on the data provided by the agency, it is estimated that this exemption costs the state approximately $32 million annually. Eliminating this exemption would subject these types of premiums to the same tax requirements as first-year premiums for other lines of insurance and provide additional revenues to the General Revenue Fund.

Using the National Council on Compensation Insurance to perform certain functions related to the establishment of rates for workers' compensation insurance. Unlike other lines of insurance such as automobile where rating bureaus such as the Insurance Services Office (ISO) perform a number of the functions related to ratemaking, the State Board of Insurance employs more than 52 individuals to: 1) collect the statistical data necessary to establish workers' compensation rates; 2) audit member and subscriber policies to check for classification codes, rates, endorsements, experience ratings, ownership changes and policy effective dates; 3) experience rate larger risks; 4) classify loss exposures; and 5) provide file maintenance and data processing support services. Until the late 1940s or early 1950s, many of these services were provided by the National Council on Compensation Insurance (NCCI). However, problems with providing accurate data in a timely manner resulted in the agency reassuming responsibility for these activities.

NCCI is a voluntary non-profit association of 635 insurers which performs a number of services for regulatory authorities in the various states. In some states, NCCI files manuals of classifications, rules prices, policy forms and other information with regulators on behalf of its members and subscribers. In certain other jurisdictions, NCCI is the legally designated statistical agency for workers' compensation insurance responsible for the collection, tabulation and analysis of all workers' compensation data. This information is then supplied to regulatory, administrative, and legislative entities in the state charged with review or ratemaking. The National Council is currently a licensed rating organization in 32 states while providing technical and production assistance in an advisory capacity in 12 additional jurisdictions, including Texas.

The results of the review indicated that the use of the NCCI for many of the functions related to the regulation of workers' compensation insurance was a possible alternative to the use of state employees. The agency indicated that it already relies on NCCI for some services and that the board's experience with

other bureaus such as the Insurance Services Office and the National Association of Independent Insurers has been generally satisfactory although occasional delays in rate development sometimes occur due to problems in gathering data. Additional services which could be provided by NCCI which are not available through the agency include the performance of field audits to assure compliance with applicable laws and regulations and the establishment of classification and rating committees to hear appeals of assigned classifications by individual policy-holders. While the transfer of these responsibilities would result in a reduction of approximately 50 state employees, the overall rates for this type of insurance may not be affected since at least some of the costs of these services would be transferred from the maintenance tax to rating bureau assessments.

ACROSS-THE-BOARD RECOMMENDATIONS

STATE BOARD OF INSURANCE

Applied	Modified	Not Applied	Across-the-Board Recommendations
			A. ADMINISTRATION
X*			1. Require public membership on boards and commissions.
X			2. Require specific provisions relating to conflicts of interest.
X			3. A person registered as a lobbyist under Article 6252-9c, V.A.C.S., may not act as general counsel to the board or serve as a member of the board.
X			4. Appointment to the board shall be made without regard to race, creed, sex, religion, or national origin of the appointee.
		X	5. Per diem to be set by legislative appropriation.
X			6. Specification of grounds for removal of a board member.
X*			7. Board members shall attend at least one-half of the agency board meetings or it may be grounds for removal from the board.
	X		8. The agency shall comply with the Open Meetings Act, and the Administrative Procedure and Texas Register Act.
X*			9. The board shall make annual written reports to the Governor and the legislature accounting for all receipts and disbursements made under its statute.
X			10. Require the board to establish skill oriented career ladders.
X			11. Require a system of merit pay based on documented employee performance.
X			12. The state auditor shall audit the financial transactions of the board during each fiscal period.
X			13. Provide for notification and information to the public concerning board activities.
X*			14. Require the legislative review of agency expenditures through the appropriation process.

*Already in statute.

Applied	Modified	Not Applied	Across-the-Board Recommendations
			B. LICENSING
X			1. Require standard time frames for licensees who are delinquent in renewal of licenses.
X			2. A person taking an examination shall be notified of the results of the examination within a reasonable time of the testing date.
X			3. Provide an analysis, on request, to individuals failing the examination.
			4. (a) Authorize agencies to set fees.
X			(b) Authorize agencies to set fees up to a certain limit.
X			5. Require licensing disqualifications to be: 1) easily determined, and 2) currently existing conditions.
X			6. (a) Provide for licensing by endorsement rather than reciprocity.
			(b) Provide for licensing by reciprocity rather than endorsement.
X*			7. Authorize the staggered renewal of licenses.
			C. ENFORCEMENT
X*			1. Authorize agencies to use a full range of penalties.
X			2. Require files to be maintained on complaints.
X			3. Require that all parties to formal complaints be periodically informed in writing as to the status of the complaint.
X			4. Specification of board hearing requirements.
			D. PRACTICE
X			1. Revise restrictive rules or statutes to allow advertising and competitive bidding practices which are not deceptive or misleading.
X			2. The board shall adopt a system of voluntary continuing education.

*Already in statute.

OTHER ISSUES

During the review of an agency under sunset, various issues were identified that related to significant changes in the current methods of regulation or service delivery. Most of these issues have been the subject of continuing debate with no clear resolution on either side.

Arguments for and against these issues, as presented by various parties contacted during the review, are briefly summarized. For the purposes of the sunset report, these issues are set out for information only and do not reflect a position taken by the sunset review.

OTHER ISSUES

The review identified several issues for which effective arguments have developed on both sides of the issue. These issues are discussed below along with an explanation of the varying viewpoints.

1. Relationship of Investment Income to Rate Devleopment.

Insurance companies receive billions of dollars of consumer funds in advance of actual performance of services and put aside funds in reserve to cover these future promises of service. Significant investment returns from these policy-holder supplied funds are generated in all lines of insurance. How much income depends on how long the company holds the money until claims are paid. The focal point of the controversy over consideration of investment income in the rate-making process has been private passenger automobile insurance, although it has also been an issue in other lines of property and casualty insurance.

Texas has, for many years, indirectly included consideration of investment income in its property and casualty rate development formulas by holding pre-tax underwriting profit loadings to five percent of earned premiums for all lines but workers' compensation which is 2.5 percent. In 1970, the recurring issue of investment income was reviewed by state officials and a special citizens committee. As a result of that study, the board adopted a policy to directly consider investment earnings from all sources in rate-making. To implement this policy, the board used a methodology that provided a target profit from all sources (underwriting and investments combined) of 5 to 6.5 percent of mean total assets after taxes for all property casualty lines combined. As long as the expected investment income plus the historical underwriting profit fell within this range, the historical profit loading of five percent of earned premiums was considered appropriate. If the total profit fell outside the target range, the profit loading was to be adjusted, but only enough to produce an expected total return at either end of the 5 - 6.5 percent range.

In late 1980, the dramatic growth in investment profits prompted the board to direct agency staff to look again at the treatment of investment income in rate-making. The staff recommended a new method for calculating investment income that was adopted on an interim basis in 1981 and has been used in rate development since that time. The impact of this revised formula can be seen in results of the use of this method which produced an underwriting profit loading of 1.8 percent in 1981 as compared to the old five percent. The use of this new approach is reported

to have saved Texas drivers $76 million and the state's homeowners $50 million in 1981.

At the same time, the interim approach was adopted, the board determined that a more exhaustive study would be beneficial. The 67th Legislature appropriated $200,000 for use during 1982 and 1983 in studying the relationship of investment income to rate development in the various lines of insurance. The agency began the study by contracting with a consultant to prepare a document outlining the various methodologies currently recognized in the field of investment income and rate-making. The report was completed in February 1982.

In October 1981, the National Association of Insurance Commissioners (NAIC) renewed its study of this issue. In an effort to avoid expensive and unnecessary duplication, the State Board of Insurance reports that it is withholding commitment of any large portion of the remaining funds until they have had a chance to review the material generated by the NAIC study. The preliminary report from NAIC is due in December 1982 with the final report being completed in June 1983. Therefore, the State Board of Insurance anticipates completion of their report by January 1984.

2. **Protest Payments of Gross Premium Taxes.**

During the past five years, there has been a growing trend for corporations paying certain business taxes to pay under protest and file lawsuits dealing with the taxes owed the state. The legal question in these suits revolving around issues related to calculating the tax rate including the percentage of business done in Texas or the percentage of investments in the state. The results of the review indicated that the volume of gross premium tax payments filed in protest by insurance companies has been steadily increasing during the period under review. As of August 31, 1981, there was $27.8 million paid in protest, of which $27.2 million or 98 percent represented payments paid in protest by foreign life companies. The legal question involved in these protest payments is the contention of foreign companies that the premium tax rates for foreign life, accident and health organizations which is 3.3 percent on a graduated scale is discriminatory since there is currently no way for these companies to pay a rate comparable to that paid by domestic companies which is 1.1 percent. Prior to 1981, this same problem existed for premium tax revenues from foreign fire and casualty companies. The 67th Legislture resolved this problem by amending Article 7064, V.A.C.S. to eliminate the discrepancy between the amounts paid by foreign and domestic companies. There is currently an advisory committee appointed by the

board addressing the problems related to the differential between tax rates for foreign and domestic life, accident and health companies. It is anticipated that this committee will recommend to the board proposed legislation that will address the problems concerning the differential between foreign and domestic companies.

3. **Less Restrictive Rate Regulation Alternatives.**

Most issuance regulatory laws require that rates be neither inadequate, excessive nor unfairly discriminatory. Although there are many variations of processes used to determine that rates conform to these standards, most procedures tend to fall into one or a combination of the several broad categories shown in Exhibit 6.

In recent years, the issue of "open rating" and other less regulated rating alternatives have become the subject of serious debate in many states. Under most open rating plans, the companies are required to file with the state insurance department those rates proposed for various lines of insurance. Some states require the proposals be approved prior to use, other simply require the rates be filed.

While most rate-regulated systems require some form of prior approval, Texas is the only state that currently promulgates state-made rates for certain lines of insurance including: property, auto, title, and workers' compensation. Prior approval of the agency is required on rates for other casualty lines and Inland Marine. The agency has no rate regulatory authority per se for life and health insurance. In lines where the board promulgates rates, the board originates rate reviews with the industry responding to actuarial proposals developed by the agency staff. In lines where companies or rating bureaus file rates for the board's approval, the state responds to proposals for rate changes initiated by companies or bureaus.

The debate concerning the best system of insurance rate regulation for Texas began with the enactment of the first statutes passed in the early 1900's and continues today. Recent modifications to the rate regulation structure which have occurred since 1957 include amendments to permit property insurers to write insurance at rates lower than the board promulgated rates and to permit automobile insurers to deviate upward or downward from promulgated rates upon agency approval. As a result of these changes, 79 percent of all property insurance was written at rates that deviated as much as 35 percent below the state-set rate and 58 percent of all automobile insurance premiums were written at deviated rates in 1981. In addition, the legislature has considered legislation which would have

eliminated the rate promulgation function of the State Board of Insurance and authorized a "file and use" system under which the actual rates would be established by the companies and filed with the commissioner prior to use. Proponents of these less restrictive alternatives argue that: 1) competition provides the greatest incentive to firms to be efficient and deliver the best possible services to consumers at the lowest cost; and 2) companies can respond more quickly to unforseen adverse economic or claims experience by adjusting rates and thereby lessening the pressure to restore rate adequacy through restrictive underwriting practices.

Proponents of the current method of rate regulation in Texas point to the fact that it was excessively low rates resulting in large numbers of insolvencies rather than excessively high rates which led to the development of the original rate regulatory laws in the early 20th century. Supporters of state-made rates also point to the assistance provided the consumer in comparing products and price provided as a result of the standard contract language which is possible with board promulgated rates. Finally, proponents also express concerns over the availability of insurance under a fully competitive rate structure. While good risks could be expected to benefit under a more competitive system, the cost to the less desirable risk would increase and the potential for there to be increased numbers of risks who would have difficulty in obtaining insurance would increase.

Exhibit 6
ALTERNATIVE RATE REGULATORY STRUCTURES

Type	Definition
State-Made Rates	The insurance department determines and promulgates the rates to which the insurer must adhere. A variation of this system permits approved deviations from state-made rates.
Mandatory Bureau Rate Systems	This system requires that an insurer obtain membership in a rating organization before it can write a given line of insurance. Members may be able to deviate from bureau rates with departmental approval. The bureau must obtain prior approval before promulgating rates.
Prior Approval Laws	Principal features of statutes in this category include the following: a) rates and supporting data filed with the insurance commissioner; b) rates not effective until prior approval of the insurance departments; c) rates must meet legal criteria and those that do not may be disapproved; and d) insurers may opt to cooperate in making rates through bureau membership or subscription.
Modified Prior Approval	Under this alternative a rate revision based solely on a change in loss experience is effective immediately upon filing, subject to subsequent disapproval by the commissioner. A rate revision based upon a change in expense relationship on rate classifications is subject to prior approval.
File and Use with Adherence to Bureau Rates Required	Under this type of rate-setting structure rates become effective immediately upon filing with no affirmative action by the commissioner required. Members or subscribers to the bureau must adhere to the filings made on its behalf by the bureau in the absence of filing for a deviation.
File and Use	Under this alternative, bureau rates are advisory only and there is no requirement that they be adhered to.

Use and File	In this case, rates may take effect immediately while the filings need not be made until some specified future time.
No File	There is no requirement that rates be filed or affirmatively approved by the commissioner in any way. Rates adopted may be put into effect immediately.
No File, No Rating Standards and No Rates in Concert	Under this alternative, insurers are expressly prohibited from agreeing with each other or with an advisory organization to adhere to the use of any statistics, policy or underwriting rules. Insurers are not subject to any filing requirements.

SOURCE: These definitions were developed by the National Association of Insurance Commissioners (NAIC) in connection with its report "Monitoring Competition: A Means of Regulating the Property and Liability Insurance Business", May, 1974.