



## SUMMARY

# A Review of the Department of Insurance



### INTRODUCTION

Members of the General Assembly requested the Legislative Audit Council to conduct an audit of the South Carolina Department of Insurance (DOI). Our audit focused on four main areas:

- Workers' Compensation Insurance
- Coastal Property Insurance
- Overall Regulation of Insurance
- Captive Insurance Companies

The South Carolina Department of Insurance (DOI) is a state agency which is responsible for supervising and regulating the financial solvency and market practices of insurers in South Carolina and ensuring that all state laws governing or relating to the business of insurance are executed. The mission of the department is to be responsible for ensuring the solvency of insurers, protecting consumers by administering and enforcing insurance laws, and regulating the insurance industry in an efficient, responsive, and equitable manner.

The department collects approximately \$175 million each year in taxes and fees from the insurance industry. As required by statute, more than 95% of that revenue is transferred to the general fund. Less than 5% is earmarked or restricted for DOI use. The General Assembly then appropriates funding for the agency, which amounts to less than 7% of the revenue that was collected.

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Our objectives were to determine how the department regulates workers' compensation insurance, coastal property insurance, other types of insurance, and captive insurance companies. We also evaluated if that regulation is in compliance with the law and insurance industry standards. As part of the coastal property insurance review, we examined the operations of the South Carolina Wind and Hail Underwriting Association. While we found that DOI generally regulates the insurance industry appropriately, we found many areas where improvement is needed to ensure that the department, the insurance industry, and the public are aware of possible problems and issues.

### WORKERS' COMPENSATION INSURANCE

We reviewed how DOI regulates workers' compensation insurance by examining rate filings and overall industry data. We also looked at how other states regulate workers' compensation insurance to recommend possible changes in state law.

- Overall, 73 (97%) of 75 of the rate filings reviewed had missing information. This information included financial data, actuarial review, and approvals. Forty-one filings (55%) were exempt from prior approval based on the deregulation in South Carolina law between 2003 and 2007.
- Without a summary document or checklist in each filing, as well as the appropriate information from insurers, it is difficult to determine if the appropriate analysis or any analysis was conducted by the department.
- State law allows insurance companies to use any year's loss cost data when calculating rates. In order to prevent the possibility of companies' manipulating rates and to be consistent with other states, state law should be amended to require insurers to use the most recently approved loss cost data when calculating rates.

### COASTAL PROPERTY INSURANCE

We reviewed how DOI regulates coastal property insurance and if that regulation is in compliance with state law and insurance industry standards. We also reviewed how the South Carolina Wind and Hail Underwriting Association (SCWHUA) operates. The regulation of coastal property insurance was also examined to determine if any changes could be made to improve the regulation in South Carolina.

- Nine (25%) of 36 filings reviewed had no evidence of DOI's review or an explanation of its decision. Completing checklists that DOI already has and including them in the file would show that the department is evaluating all aspects of the filings and how it reached its decision.
- As required by state law, SCWHUA should include procedures in its plan of operation for procurement of reinsurance. These procedures should include better use of evaluation criteria to make the process more open and objective.
- The department should continue its efforts to evaluate hurricane models for South Carolina to ensure that the rates charged by insurers are appropriate.

## OVERALL REGULATION OF INSURANCE

We reviewed how the department regulated other types of insurance such as life, health and automobile insurance. We looked at how DOI ensures the financial solvency of insurance companies and reviews rate increase requests.

- We reviewed rate changes submitted to the Department of Insurance (DOI) to determine whether adequate procedures were in place for analyzing the requests in order to make appropriate decisions for approval or denial. We generally found adequate support for the decisions, with two exceptions. By failing to document all aspects of a rate change request, the department's decisions may not be adequately explained or supported.
- We reviewed the operations of the financial analysis division to determine if the Department of Insurance (DOI) ensures that insurance companies comply with the South Carolina law and National Association of Insurance Commissioners' (NAIC) guidelines. We found that the files contained adequate documentation to establish that desk audits had been conducted in accordance with South Carolina laws and NAIC regulations. However, none of the samples indicated that the risk based capital ratio had been agreed between the company's annual statement and the NAIC calculations.
- Our examinations of the DOI schedule of audits confirmed that examinations were scheduled and completed in accordance with state law.

## CAPTIVE INSURANCE

We reviewed the Department of Insurance's (DOI) regulation of captive insurance companies which are a risk-financing method or a form of self-insurance involving the formation of companies to serve the insurance needs of parent companies or their members. We found that generally the department's licensing and examinations of captives complies with state law and regulations. We did find the following problems with their regulation of captives:

- We found that the department did not collect all of the required information from companies. Without this information, the department may not be able to adequately determine if the company will be able to remain financially solvent and protect its parent company or members.
- The department did not have standard procedures for conducting the financial examinations of captives which are not risk retention groups or special purpose financial captives. These examinations are required by state law. The agency has now developed standard procedures and, according to an agency official, implemented them in December 2008.
- We reviewed DOI's schedule of examination dates for captives and found that 43 (81%) of 53 reviews have not been completed within the three-year period required by state law. By not having procedures as discussed above and failing to complete examinations as required by law, the department cannot adequately ensure that the captive insurance companies are able to meet their financial obligations.

AUDITS BY THE LEGISLATIVE  
AUDIT COUNCIL CONFORM TO  
GENERALLY ACCEPTED  
GOVERNMENT AUDITING  
STANDARDS AS SET FORTH BY  
THE COMPTROLLER GENERAL OF  
THE UNITED STATES.

### FOR MORE INFORMATION

Our full report,  
including comments from  
relevant agencies,  
is published on our website.  
Copies can also be obtained by  
contacting our office.

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