Report Highlights

Louisiana Department of Insurance

Flexible Rating Program

January 2006

Louisiana Legislative Auditor

The Louisiana Department of Insurance (LDI) through its Office of Property and Casualty (P&C) manages the Flexible Rating system for the state. The Flexible Rating system is a process by which insurance providers can submit rate changes directly to LDI and avoid going before the Louisiana Insurance Rating Commission (LIRC). The primary purpose of the Flexible Rating Program is to increase competition among insurers and to decrease the rate at which insurance rates are increasing within the state.

Audit Results

LDI Can Manage the Flexible Rating Program More Effectively.

- LDI is ensuring that companies changing rates through the flexible rating provision are in compliance with the flex band set in law. There are some additional steps that LDI can implement to ensure the Flexible Rating Program is managed more efficiently such as using reliable premiums, monitoring insurance providers, and updating its database.

The Flexible Rating Program Is More Efficient Than the LIRC Prior Approval Process.

- The Flexible Rating Program is a more efficient process than the Prior Approval process. All rate changes for plus or minus 10% should be processed through flexible rating when applicable because the process is more efficient. In addition, reviewing all rate change request within 30 days will help ensure that only actuarially justified rates are implemented.

LDI May Not Be Able to Report the Impact of Flexible Rating on Insurance Rates and Competition as Required in 2008.

- LDI may not be able to meet some of its rating reporting requirements in 2008. One of the reasons that LDI may not meet all of its reporting requirements is the reporting requirements for Flexible Rating are not clearly defined. In addition, any changes in the insurance industry as identified by the reporting requirements cannot be solely contributed to the flexible rating program.

Steve J. Theriot, CPA

Legislative Auditor

Is the Flexible Rating Program Administered to Ensure Compliance With Current Legal Requirements?

WHAT WE FOUND

LDI can administer the Flexible Rating Program more effectively.

- LDI is ensuring that companies changing rates through the flexible rating provision are in compliance with the flex band set in law.
- LDI should explore ways to help ensure that accurate and reliable premium, loss, and expense data are used for the actuarial review process.
- Creating a more efficient way to monitor insurance providers will help LDI ensure that insurance providers only implement approved rates.
- Updating the Comprehensive Agenda Tracking System (CATs) database will allow reporting from one central source of data.

RECOMMENDATIONS

- ✓ LDI should consider developing a process to ensure that premium, loss, and expense data used in its actuarial justification process are as accurate as possible since these premiums are the driving force behind rate change request approvals.
- ✓ LDI should consider monitoring a more representative number of P&C policies to ensure that only approved rates are implemented by insurance providers.
- ✓ LDI should explore ways to expand the scope of its rate audits to include a sample of similar policies when inaccurate rates are detected within a questioned policy.
- ✓ LDI should add the additional necessary fields to its CATs database to capture all programmatic data for flexible rating. This data should be used to report on the impact of the Flexible Rating Program.

MATTER FOR LEGISLATIVE CONSIDERATION

- ✓ The legislature may wish to amend Revised Statute 22:1401(J) to specifically state at what level the 10% flex band applies. The statute contains vague language that may be interpreted differently by LDI, insurers, and consumers.

Is the Flexible Rating Program More Efficient Than the LIRC Prior Approval Process?

WHAT WE FOUND

The Flexible Rating Program is more efficient than the LIRC Prior Approval process.

- In 2004, it took approximately half as much time for a company to have a rate or rule change approved through the flexible rating program then it did through the LIRC prior approval process.
- Reviewing all rate change request within 30 days will help ensure that only actuarially justified rates are implemented.
- All rate changes for plus or minus 10% should be processed through flexible rating when applicable.

RECOMMENDATION

- ✓ LDI should consider developing and implementing procedures to ensure that all rate and rule change request filed through the Flexible Rating Program are reviewed within 30 days.

MATTER FOR LEGISLATIVE CONSIDERATION

- ✓ The legislature may wish to consider changing the law to require all rate changes within the flex band of +/-10% that are eligible for flexible rating to be filed through the flexible rating process.

Will LDI Be Able to Report the Impact of Flexible Rating on Insurance Rates and Competition as Required in 2008?

WHAT WE FOUND

LDI may not be able to report the impact of flexible rating on insurance rates and competition as required in 2008.

- The 2008 reporting requirements for flexible rating are not clearly defined.
- LDI may not be able to meet some of the 2008 flexible rating reporting requirements.
- Any changes in the insurance industry as identified by the reporting requirements cannot be solely attributable to the Flexible Rating Program.

RECOMMENDATIONS

- ✓ LDI should work with the legislature to clearly define the 2008 reporting requirements for Flexible Rating.
- ✓ LDI should formally inform the legislature of the limitations that exist when trying to attribute changes in rates and competition solely to flexible rating, prior to issuing its report in 2008.

Louisiana Legislative Auditor

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Questions? Call Steve Theriot at 225-339-3800.

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LOUISIANA DEPARTMENT OF INSURANCE
FLEXIBLE RATING PROGRAM

PERFORMANCE AUDIT
ISSUED JANUARY 11, 2006

LEGISLATIVE AUDITOR
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January 11, 2006

The Honorable Donald E. Hines,
President of the Senate
The Honorable Joe R. Salter,
Speaker of the House of Representatives

Dear Senator Hines and Representative Salter:

This report provides the results of our performance audit of the Flexible Rating system, which is administered by the Louisiana Department of Insurance (LDI). This audit was conducted under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended.

Our audit work was completed in July 2005. We subsequently drafted a report and scheduled a meeting to discuss the draft with LDI on September 1, 2005. This meeting and the issuance of this audit were delayed because of hurricanes Katrina and Rita.

This report contains our findings, conclusions, and recommendations. Appendix B contains LDI's response. I hope this report will benefit you in your legislative decision-making process.

Sincerely,

Steve J. Theriot, CPA
Legislative Auditor

SJT/ss

[LDIFRP05]

Exhibits

Exhibits (Concluded)

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EXECUTIVE SUMMARY

The Louisiana Department of Insurance (LDI) through its Office of Property and Casualty manages the Flexible Rating System for the state. We reviewed historical LDI program data for calendar years 2000, 2001, 2002, 2003, and 2004. Our findings are summarized below.

Performance Audit Findings

LDI Can Administer the Flexible Rating Program More Effectively.

- LDI is ensuring that companies changing rates through the flexible rating provision are in compliance with the flex band set in law.
- LDI should explore ways to help ensure that accurate and reliable premium, loss, and expense data are used for the actuarial review process.
- Creating a more efficient way to monitor insurance providers will help LDI ensure that insurance providers only implement approved rates.
- Updating the Comprehensive Agenda Tracking System (CATs) database will allow reporting from one central source of data.

The Flexible Rating Program Is More Efficient Than the Louisiana Insurance Rating Commission (LIRC) Prior Approval Process.

- In 2004, it took approximately half as much time for a company to have a rate or rule change approved through the flexible rating program than it did through the LIRC prior approval process.
- Reviewing all rate change request within 30 days will help ensure that only actuarially justified rates are implemented.

LDI May Not Be Able to Report the Impact of Flexible Rating on Insurance Rates and Competition as Required in 2008.

- The 2008 reporting requirements for flexible rating are not clearly defined.
- LDI may not be able to meet four of the eight rating reporting requirements in 2008.
- Any changes in the insurance industry as identified by the reporting requirements cannot be solely attributable to the Flexible Rating Program.

INTRODUCTION

Audit Initiation and Objectives

This performance audit was conducted under the provision of Title 24 of the Louisiana Revised Statutes of 1950, as amended. Louisiana Revised Statute 24:522 requires, in part, that the legislative auditor establish a schedule of performance audits to ensure that at least one performance audit is completed and published for each executive department agency within a seven-year period beginning with the 1997-98 fiscal year. In accordance with this requirement, the Office of Legislative Auditor developed a plan scheduling a performance audit of the Louisiana Department of Insurance (LDI) for the 2004-05 fiscal year. The scheduling of this audit was approved by the Legislative Audit Advisory Council in July 2003. We began the audit in January 2005.

The objectives of this audit are:

- Is the Flexible Rating Program Administered to Ensure Compliance With Current Legal Requirements?
- Is the Flexible Rating Program More Efficient Than the Louisiana Insurance Rating Commission (LIRC) Prior Approval Process?
- Will LDI Be Able to Report the Impact of Flexible Rating on Insurance Rates and Competition as Required in 2008?

Overview of the Louisiana Department of Insurance

Function and Funding. The mission of LDI is to promote a financially sound, consumer-responsive insurance environment in the state through fair, consistent regulation, to the end that insurance be both available and affordable in the State of Louisiana. LDI's existing operating budget for fiscal year 2005 is approximately $27 million with 277 authorized full-time positions. As shown in Exhibit 1 on the following page, most of LDI's revenue is from fees and self-generated revenue.

Exhibit 1
Summary of LDI's Actual and Budgeted Expenditures by Revenue Source
Fiscal Year 2004 Through 2006

Source of Funding	Fiscal Year 2004 Actual Expenditure	Fiscal Year 2005 Existing Operating Budget	Fiscal Year 2006 Budget Request
General Fund	$0	$0	$0
Interagency Transfers	$0	$0	$0
Fees & Self-Generated	$22,990,268	$25,644,030	$27,603,094
Statutory Dedications	$828,969	$1,090,303	$1,099,809
Interim Emergency Board	$0	$0	$0
Federal Funds	$221,536	$257,586	$268,564
Total	**$24,040,773**	**$26,991,919**	**$28,971,467**

Source: Prepared by legislative auditor's staff using information from the executive budget.

Organization. LDI is organized around two programs: (1) Administration/Fiscal Program and (2) Market Compliance Program. Our audit focuses on the Office of Property and Casualty within the Market Compliance Program. The Market Compliance Program is responsible for reviewing property and casualty rate requests from insurance companies, including rate requests through the Flexible Rating Program.

Property and casualty includes two primary types of insurance lines of business. These primary types of business are personal lines and commercial lines. Personal lines include homeowners, mobile home, private passenger automobile, recreational vehicle, personal umbrella, and others. Commercial lines include all lines that are not personal lines.

Each line of business is further subdivided into programs. The programs are then subdivided into coverage areas. Exhibits 2 and 3 below illustrate how the lines of business are subdivided.

Exhibit 2
How Lines of Business Within Property and Casualty Are Subdivided
Example Using Automotive Line of Business

Level	Example
Line of Business	• Automotive
Program	• Preferred Driver Program • Preferred Gold Driver Program
Coverage	• Liability • Comprehensive • Collision • Bodily Injury • Medical Payments • Property Damage

Source: Prepared by legislative auditor's staff using information from LDI.

Exhibit 3
How Lines of Business Within Property and Casualty Are Subdivided
Example Using Homeowners Line of Business

Level	Example
Line of Business	• Homeowners
Program	• Premium Plus Homeowners Program
Coverage	• Dwelling • Personal Property • Liability • Medical Payments

Source: Prepared by legislative auditor's staff using information from LDI.

Requesting Insurance Rate Changes in Louisiana

Overview of Insurance Rates. Insurance companies collect premiums from the people they insure. According to LDI, premiums are the amounts assessed by the insurer as consideration for the purchase of insurance for a definitely stated term. The determination of premium is based on LIRC or LDI approved rules applied to approved rates. In other words, premiums are a result of rates.

Rate determination, which is the reason rate changes are requested, is the process of calculating a price to cover the future cost of insurance claims and expenses, including a margin for profit. To establish rates, insurers look at past trends and changes in the current environment that may affect potential losses in the future. Rates vary according to the likelihood and potential size of loss. Louisiana Revised Statute (R.S.) 22:1404(6) defines the term "rate" as:

(1) the premium to be paid by or charged to the insured for insurance, including fees and charges and

(2) the elements and factors forming the basis for the determination of the premium, including fees and charges.

Insurance rates are regulated by states. While the regulatory processes in each state vary, three principles guide every states' rate regulation system: (1) that rates be adequate (to maintain insurance solvency); (2) that rates are not excessive (not so high as to lead to exorbitant profits); and (3) rates are not unfairly discriminatory (price differences must reflect expected claim and expense differences). Recently, in auto and home insurance, the issues of availability and affordability, which are not explicitly included in the guiding principles, have been assuming greater importance in regulatory decisions. In line with these principles, states have adopted various methods of regulating insurance rates, which fall roughly into two categories: "prior approval" and "flexible rating."

Rate Changes in Louisiana. During the audit period of January 1, 2004, to December 31, 2004, with a few additional methods allowed by state law, there were two main ways for insurance providers in Louisiana to file for a rate change:

(1) **Prior Approval** - Rate requests from insurance companies go through the LIRC, which historically approved all rate changes. Louisiana is a modified prior approval state, which means that some property and casualty rates and rules must be filed with the LIRC and approved before they can be used. In other words, some insurance rates have to be *approved* by the LIRC *prior* to being implemented by insurance companies. All rate change requests for greater than +/- 10% must be approved through the prior approval process by the LIRC. However, insurance providers can only submit one rate increase request through the LIRC prior approval process during a twelve-month period. For rate change request less than or equal to +/-10%, the insurance provider can submit a rate request through either the prior approval or flexible rating process.

(2) **Flexible Rating** - Insurance providers can submit rate change requests directly to LDI and avoid going before the LIRC. During the 2003 Regular Legislative Session, the legislature enacted R.S. 22:1401(J). The statute states that overall average rate level increases or decreases in any 12-month period, for all coverages combined for both personal and commercial lines, of 10% above or below the insurer's rates in effect, may take effect without prior approval of the LIRC. The primary purpose of the Flexible Rating Program is to increase competition between insurers and to decrease the rate at which insurance rates are increasing. Exhibit 4 below highlights the differences between Prior Approval and Flexible Rating.

Exhibit 4
Differences Between Prior Approval and Flexible Rating

Process	Prior Approvals	Flex
Filing	• All requests for rate changes over +/- 10% must be filed as Prior Approval Filings. • Companies may request rate changes under +/- 10% go through the prior approval process. • Company can only submit one request for a rate change increase in a twelve-month period regardless of the amount. A reduction in rates may be approved at any time. • Company must submit packet of standard documents and other information for rate change requests to LDI.	• Company can file rate change requests under flexible rating as frequently as it wants as long as the rate does not change cumulatively more then +/- 10% in a 12-month period. • Company must submit packet of standard documents for rate change requests to LDI.
Review	• LDI analyst reviews packet for completeness and compliance with the law. • Actuary reviews rate request.	• LDI analyst reviews packet for completeness and compliance with the law. • Actuary reviews rate request.
Approval	• LIRC approves rate request. • LIRC is not required to use the actuary's recommendation. The LIRC can approve a request that is not actuarially justified or disapprove a request that is actuarially justified.	• Rate becomes effective without prior approval of the LIRC if LDI determines that the filing is within the approved flex band and is actuarially justified.

Source: Prepared by legislative auditor's staff using information from LDI and Louisiana Revised Statutes.

Rate Changes Prior to January 1, 2004. Prior to January 1, 2004, the main way an insurance company could make a change to its rates for Personal and Commercial lines of business was to get the "prior approval" of the LIRC. The LIRC met once a month and approved all rate increases and decreases. However, an insurance company did have the ability to adjust its rates between the highest and lowest approved rates without obtaining additional approvals from the LIRC. Therefore, if a company had a 15% decrease that was approved by the LIRC; it could later increase rates back to their previous level without further approval from the LIRC as long as the increases were actuarially justified. The capability for adjustments also applied to LIRC approved increases and actuarially justified decreases. While these changes did not have to be approved by the LIRC, the insurer did have to give written notification to the commission of the change and had to provide information as requested by the commission to determine if the rate increase or decrease was actuarially justified. These provisions, which were part of R.S. 22:1401 J(2) and J(3), were later removed by ACT 351 of the 2003 Regular Legislative Session.

Rate Changes During 2004. The flexible rating law became effective January 1, 2004, which allowed insurance companies to circumvent LIRC approval for rate changes within a flex band of +/- 10%. During 2004, the flexible rating law applied to personal and commercial lines of business. However, all rate changes outside of the flex band still needed prior approval through the LIRC, as did any changes subsequent to a company reaching the maximum increase or decrease of 10% within a 12-month period. Exhibit 5 summarizes the written premiums for all personal and commercial lines of business in Louisiana during calendar year 2004.

Exhibit 5
Property and Casualty Premiums Regulated by LDI
As of December 31, 2004

Line of Business	Written Premium	Percentage of Total
Private Passenger Automobile	$2,932,650,168	39.40%
Homeowners	$925,021,756	12.43%
Commercial	$3,585,930,286	48.17%
Statewide Totals	**$7,443,602,210**	**100.0%**

Source: Prepared by legislative auditor's staff using documentation provided by LDI.

Rate Changes After January 1, 2005. The Commercial lines of business were deregulated on January 1, 2005, which meant that prior approval through the LIRC or actuarial justification through flexible rating was no longer required for commercial rate changes. Beginning January 1, 2005, only personal line filings were subject to either flexible rating or LIRC processes.

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IS THE FLEXIBLE RATING PROGRAM ADMINISTERED TO ENSURE COMPLIANCE WITH CURRENT LEGAL REQUIREMENTS?

LDI's flexible rating program is in compliance with current legal requirements. All 114 requests filed through the Flexible Rating Program in 2004 for automobile and homeowners rates met the limits for rate changes established in law. However, while testing for compliance with legal requirements, we identified three areas where LDI has opportunities to improve the effectiveness of the program.

- LDI should explore ways to help better ensure that premium data submitted by insurance companies are accurate and reliable by verifying the data to external sources.
- LDI should consider reviewing a larger number of insurance providers, on an annual basis, to better ensure that only approved rate changes are implemented.
- LDI could improve its monitoring and reporting on the impact of the Flexible Rating Program if enhancements are made to its CATs database.

LDI Is Ensuring That Companies Changing Rates Through the Flexible Rating Provision Comply With the Flex Band Set in Law

LDI complied with the new flexible insurance rating law by ensuring that all approved rate requests were within the 10% limit on rate increases. R.S. 22:1401(J)(2), which created flexible rating, states, in part, that overall average rate level increases or decreases in any 12-month period, for all coverages combined for both personal and commercial lines, of 10% above or below the insurer's rates in effect, may take effect without prior approval. As discussed in the background of the report, automotive and homeowners insurance are divided into programs and coverages. The law is not clear as to what level the 10% limit on rate increases should be applied. As shown in Exhibit 6, LDI interprets the law to mean that the 10% limit on rate increases "for all coverages combined" applies to individual programs.

Exhibit 6
How Lines of Business Within Property and Casualty Are Subdivided
Example Using Automotive Line of Businesses

Level	Example	LDI Interpretation of Flexible Rating Law
Line of Business	• Automotive • Homeowners	
Program	Automotive Example • Preferred Driver Program • Preferred Gold Driver Program	An insurance company can get a 10% rate increase for each individual program.
Coverage	Automotive Example • Liability • Comprehensive • Collision • Bodily Injury • Medical Payments • Property Damage	The weighted average of changes for all coverages within individual programs cannot exceed 10%.

Source: Prepared by legislative auditor's staff using information from LDI.

In 2004, LDI reviewed 114 requests filed through the flexible rating provision. All of the requests filed were in compliance with applicable law based on LDI's interpretation. LDI approved 55 requests for private passenger automobile rates and approved 35 requests for homeowner rates.

As previously mentioned, LDI applies the 10% limit on rate increases to individual programs. The rate change request is an estimate based on the weighted average, using written premiums, of the changes in coverage within the individual program. An insurance company can request, and receive, multiple rate increases or decreases within a line of business at the program level especially private passenger automobile, which offers multiple programs to consumers. For example, an insurance provider may request a 10% increase for its Preferred Driver Program and another 10% increase for its Preferred Driver Gold Program. LDI would approve both 10% increases as long as they were actuarially justified.

As seen in Exhibit 7, an insurance company can request large increases for multiple coverages within a program and then offset them with smaller decreases so that the overall weighted change within a specific product is within the approved flex band. In this example, the increase in written premiums is expected to increase from $5,891,853 to $6,434,461 or 9.2%. It should be noted that rate changes are very complex and that the 9.2% increase would only be an estimate of the change in premium based on the requested rate change. The +9.2% in this example would represent a statewide average rate change. It can be expected that an individual policy will experience a rate revision either greater or less than +9.2%, possibly by a large margin.

Exhibit 7
Example of Multiple Rate Change Requests Within the Same Line of Business
(Automotive Line of Business)

Insurance Program	Effective Date	Increase Decrease
Preferred Driver Gold	4/01/05	+9.2%

Source: Prepared by legislative auditor's staff using information from LDI.

Change in Coverage Equal to the +9.2% Rate Change Affecting 3,761 Policies

Coverage Type	Change in Coverage	Premium Before Rate Change	Increase or Decrease in Premium	Premium After Rate Change
Bodily Injury	+26.6%	$1,774,225	$471,944	$2,246,169
Property Damage	+21.0%	$718,966	$150,983	$869,949
Medical Payments	-2.9%	$137,601	-$3,990	$133,611
Comprehensive (OTC)	-2.5%	$1,142,955	-$28,574	$1,114,381
Collision	-2.9%	$1,316,385	-$38,175	$1,278,210
Uninsured Motorist BI	-1.2%	$761,985	-$9,144	$752,841
Uninsured Motorist PD	-0.8%	$19,434	-$155	$19,279
Towing	-1.4%	$18,831	-$264	$18,567
OTC Auto Loan/Lease	-1.9%	$376	-$7	$369
Coverage for Loss of Life/Limb	-1.7%	$387	-$7	$380
Extended Transaction	-.04%	$708	-$3	$705
Weighted Average	**+9.2%**	**$5,891,853**	**$542,608**	**$6,434,461**

Matter for Legislative Consideration: The legislature may wish to amend R.S. 22:1401(J) to specifically state at what level the 10% flex band applies. The statute contains vague language that may be interpreted differently by LDI, insurers, and consumers.

LDI Should Ensure That Accurate and Reliable Premium, Loss, and Expense Data Are Used for the Actuarial Review Process

When LDI is actuarially justifying rate changes for requests through Flexible Rating and the LIRC prior approval process, it uses premiums that were submitted by the insurance provider. LDI tests the premium amounts for reasonableness by comparing the premium amounts to those included in prior rate changes. However, except for rare occasions, it does not verify that the premium amount is accurate by using information other than self-reported information from the insurance provider.

According to LDI, it does not verify the accuracy of the premiums using external data because it is a moving target and outside an audit or an inspection of company records, the department trusts the companies to submit accurate information. Furthermore, R.S. 22:1416 states that no person or organization shall willfully withhold information from or knowingly give false or misleading information to the commission, the office of property and casualty, any statistical agency designated by him, any rating organization, or any insurer which will affect the rates or premiums chargeable. A violation shall subject the one guilty of such violation to the penalties provided under law. A corporation shall be fined not more than $50,000 and a person shall be fined not more than $10,000, or imprisoned for not more than five years, or both.

It is important that LDI verify that the company reported premium is reasonable using something other than self-reported information because the written premium amount is the driving factor in the actuarial justification process. Without independent verification of premium amounts, LDI cannot be assured that it is basing its analysis on accurate information.

LDI staff agrees that it may be able to review, on a sample basis each year, submitted premiums to ensure they are accurate. According to LDI officials, the department may be able to verify this information using data from its Financial Solvency and/or Tax departments. Furthermore, LDI stated that it would remind insurance companies of their duty to report accurate information, or best estimates in this case, by including the provisions of R.S. 22:1416 in its application process for rate change requests. In addition to verifying premium data submitted by companies, LDI indicated that both loss and expense data are as important as premium data and are more volatile. Not including them in efforts to ensure accuracy would be remiss on LDI's part.

Recommendation 1: LDI should consider developing a process to ensure that premium, loss, and expense data used in its actuarial justification process are as accurate as possible since these premiums are the driving force behind rate change request approvals.

LDI's Response: We agree with this recommendation and will look at means to ensure the accuracy of reported premium, loss, and expense data.

Creating a More Efficient Way to Monitor Insurance Providers Will Help LDI Ensure That Insurance Providers Only Implement Approved Rates

Once LDI approves a rate change, it does not have an effective way to verify that the company implemented the correct rate. LDI does verify rates during market conduct examinations; however, these examinations are rare. In addition, in the past, LDI audited every insurance policy in the state. However, LDI decided reviewing every policy was too cumbersome and it was not cost beneficial to do so. LDI decided to change its policy and only review insurance policies if there was a consumer complaint. During 2004, LDI reviewed 227 Property and Casualty (P&C) policies because of rate complaints. However, according to LDI officials, the department does not expand the scope of its audits when it finds that inaccurate rates are being applied to a questioned policy. Without a more effective verification process, there is a risk that insurance companies could implement rate changes other than those approved by LDI.

Recommendation 2: LDI should consider monitoring a more representative number of P&C policies to ensure that only approved rates are implemented by insurance providers.

LDI's Response: We agree in principal but we believe that we already audit the rates implemented by companies sufficiently to protect the public. We would be willing to expand our audit scope if expanding the monitoring of Property and Casualty policies can be performed with existing resources.

Recommendation 3: LDI should explore ways to expand the scope of its rate audits to include a sample of similar policies when inaccurate rates are detected within a questioned policy.

LDI's Response: We agree in principal but we believe that we already perform this expansion of scope when inaccurate rates are detected within a single policy.

Updating the Comprehensive Agenda Tracking System Will Allow Reporting From One Central Source of Data

LDI maintains data on insurance company rate requests in a centralized database called the Comprehensive Agenda Tracking System (CATs). LDI's CATs database does not capture all data necessary to monitor and report the impact of the Flexible Rating Program. The missing data include, but are not limited to, separate fields for “the requested rate change,” “the approved rate change,” and “the amount of the change.” The missing data, along with other fields, are necessary for LDI to ensure the flexible rating program is administered in accordance with state law.

As a result of critical data fields not being captured in the CATs database, LDI maintains separate spreadsheets to record the data. For example, the actuary and rating staff each had to develop his/her own spreadsheet to track necessary programmatic information. Currently, LDI is using one of these separate spreadsheets to create reports on the Flexible Rating Program. When data are tracked separate from an agency’s centralized computerized system, the data are less likely to be reliable. Furthermore, data are not readily available when needed and reporting may become cumbersome.

According to LDI, the data are not being captured because the database was created prior to the establishment of the flexible rating program. If the critical data fields were added to the CATs database, it would help LDI effectively monitor the flexible rating program. LDI staff agrees that adding additional fields to the CATs database would be beneficial. LDI staff has already created a list of data fields it wants added to the CATs database and has given the information to its information technology division.

Recommendation 4: LDI should add the additional necessary fields to its CATs database to capture all programmatic data for flexible rating.

LDI’s Response: We concur with the recommendation. LDI was in the planning process of improving the CATs system prior to the hurricane.

Recommendation 5: Once the necessary fields are added to the CATs database, LDI should use this centralized source of data to report on the impact of the Flexible Rating Program.

LDI’s Response: We concur with the recommendation.

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IS THE FLEXIBLE RATING PROGRAM MORE EFFICIENT THAN THE LIRC PRIOR APPROVAL PROCESS?

The Flexible Rating Program is a more efficient way for companies to change rates and rules than through the LIRC prior approval process. On average, in 2004, it took approximately half the time (20 fewer days) for a company to have a rate or rule change approved through the flexible rating program than it did through the LIRC prior approval process.

The filing and review processes are essentially the same for Flexible Rating requests and LIRC prior approval requests. The same actuary performs the same reviews for both processes. However, the Flexible Rating Program saves time because the insurance companies do not have to wait to get on an LIRC agenda and wait for one of the monthly meetings to discuss the rate request. According to LDI staff, it may also be less expensive for companies to file through flex since they usually have to have company representatives present at the LIRC meetings.

As allowed by state law, some companies chose to submit requests through the LIRC prior approval process that were eligible to go through the Flexible Rating Program. However, the trend is that more companies are filing under the flexible rating provision when they can.

Reviewing All Rate Change Requests Within 30 Days Will Help Ensure That Only Actuarially Justified Rates Are Implemented

LDI reviewed 89.8% of the rate change requests filed under the flexible rating provision in 2004 within 30 days. Of the 108 requests reviewed by LDI in 2004, 11 (10.2%) took over 30 days to review. On average, LDI took 21 days to review these requests. LDI reviews the requests to determine if they meet legal and actuarial requirements. It is important for LDI to review requests within 30 days because under the flexible rating provision, a rate change can become effective after 30 days unless LDI issues an order stating that the filing does not meet necessary legal or actuarial requirements.

A risk exists that a flexible filing that does not meet requirements will be implemented by a company if LDI does not issue an order to stop the filing before it is eligible to take effect. However, there were no instances where a rate that did not meet requirements went into effect. We reviewed all 18 requests that LDI determined did not meet legal or actuarial requirements in 2004. One of the 18 requests (5.6%) took longer then 30 days for LDI to review. However, the request had an effective date of greater than 30 days, so it did not impact current rates.

LDI staff realizes the importance of determining if rate requests meet the necessary requirements within 30 days. The majority of the requests that took over 30 days to review were during the first three months of the Flexible Rating Program when LDI's staff was working with companies in attempt to inform them and assist them in filing under the new program.

Recommendation 6: LDI should consider developing and implementing procedures to ensure that all rate and rule change request filed through the Flexible Rating Program are reviewed within 30 days.

LDI's Response: We agree in principal with this Recommendation. The LDI makes every effort to complete the rate review within the allotted 30 days. However, it is not always within the LDI's control to "ensure" the filing will be completed during the 30 day waiting period.

All Rate Changes for Plus or Minus 10% Should Be Processed Through Flexible Rating When Applicable

Flexible rating change requests are approved more quickly than requests through the LIRC prior approval process. It takes about half as much time for LDI to determine that a flexible rating change meets requirements versus a rate change request approved through the LIRC. As stated earlier, the average time to determine that flex filings met legal and actuarial requirements was 21 days in 2004. According to information in LDI's CATs database, requests that went through the LIRC in 2004 took an average of 41 days to approve.

According to LDI staff, part of the purpose of the flexible rating provision is to allow companies to make rate changes more frequently and to create a faster method to change rates, which allows companies to keep up with changes in the market. Since the filing and review processes are essentially the same for the two filings methods, the time saved is in the approval process. It is faster to file through flexible rating than through prior approval because under flexible rating, the filing does not have to wait until a board meeting to be approved which can delay the approval process significantly. The LIRC prior approval process varies depending on when the request is submitted and whether LDI staff can review the request in time to make the agenda for the upcoming board meeting.

Not all rate changes eligible for flexible rating were filed through flexible rating. During 2004, there were 92 requests for rate changes filed with LDI. Twenty-one of these rate change requests were filed through the LIRC prior approval process. However, 12 of the 21 rate change requests (57.1%) were eligible for flexible rating. Because of the increased efficiencies with flexible rating, it would benefit insurance providers to file all eligible rate changes through flexible rating. According to LDI, these rate changes were filed under prior approval for three reasons:

1. The insurance provider was not familiar with flexible rating because it was new to the state's insurance industry.

2. The changes were submitted in late 2003 and not approved by the LIRC until after January 2004 at the same time flexible rating was being implemented.

3. The insurance provider consciously chose to file through the LIRC rather than through flexible rating, as allowed by state law.

Exhibit 8 summarizes the 12 rate changes processed through prior approval that were eligible for flexible rating.

Exhibit 8
2004 Approvals for Plus or Minus 10% That Were Approved by the LIRC

Line of Business	Approved Through Prior Approval	Eligible For Flexible Rating	Percentage
Automobile	13	9	69.2%
Homeowners	8	3	37.5%
Total	**21**	**12**	**57.1%**

Source: Prepared by legislative auditor's staff using information provided by LDI.

Matter for Legislative Consideration: The legislature may wish to consider changing the law to require all rate changes within the flex band of +/-10% that are eligible for flexible rating to be filed through the flexible rating process.

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WILL LDI BE ABLE TO REPORT THE IMPACT OF FLEXIBLE RATING ON INSURANCE RATES AND COMPETITION AS REQUIRED IN 2008?

It does not appear that LDI will be able to meet all of its 2008 reporting requirements. State law requires the LIRC to deliver to the legislature a report on the impact of flexible rating for property and casualty insurance on or before February 1, 2008. LDI may not be able to meet its reporting requirements primarily because LDI does not collect some of the necessary information from insurance providers.

The 2008 Reporting Requirements for Flexible Rating Are Not Clearly Defined

When the legislature created the flexible rating program during the 2003 Regular Legislative Session, it included reporting requirements in the new law. However, these reporting requirements are not clearly defined. R.S. 22:1401(J)(6) requires LIRC to deliver to the legislature a report on flexible rating for property and casualty insurance on or before February 1, 2008. The report shall analyze the impact of the flexible rating program on the following:

- Extent and nature of competition
- Size and significance of coverage
- Level and range of rates and rate changes among insurers
- Extent of consumer complaints to LDI
- Volume of cancellations and non-renewals
- Changes in the number of policies by territory and by class, including age and sex in each territory
- Number of new insured and non-renewed insured
- Business written by each insurer

The Louisiana Flexible Rating Program is modeled after a program in South Carolina. The reporting requirements in Louisiana law are identical to reporting requirements in the South Carolina law establishing its program. However, LDI has not worked with the legislature to obtain a clear understanding of the (1) definition of each requirement; (2) explanation for how each should be measured; or (3) a time frame to cover in the reporting. Therefore, LDI has not identified exactly what information it needs to report to satisfy the intent of the law.

Recommendation 7: LDI should work with the legislature to clearly define the 2008 reporting requirements for flexible rating.

LDI's Response: We concur with the recommendation. The LDI will contact the Legislature prior to the 2006 regular session to discuss the difficulties LDI has with reporting on a few of the statutory requirements.

LDI May Not Be Able to Meet Some of the 2008 Flexible Rating Reporting Requirements

We worked with LDI to identify potential information it could use to satisfy each reporting requirement. It appears that LDI has available data for four of the eight reporting requirements. LDI does not collect or have access to data to report on three of the requirements and one requirement appears to be duplicative of the information in another requirement. Exhibit 9 below summarizes the reporting requirements and available information. As mentioned previously, these reporting requirements are not clearly defined in state law. The potential information we present in this section can serve as a possible starting point for defining these requirements. As recommended earlier, LDI should still meet with legislative staff to clearly define these requirements. The following charts lists examples of what information can be provided by LDI to help answer some of the reporting requirements. However, to show the true impact flexible rating has had on the insurance industry in Louisiana, LDI is considering contracting with an economist.

Exhibit 9
Summary of Flexible Reporting Requirements

Information Available to Measure	No Information Available to Measure	Appears to Duplicate Another Requirement
• Extent and nature of competition • Size and significance of coverage • Level and range of rates and rate changes among insurers • Extent of consumer complaints to LDI	• Changes in the number of policies by territory and by class including age and sex in each territory • Volume of cancellations and non-renewals • Number of new insured and non-renewed insured	• Business written by each insurer*

*****Appears to report on the same information as required by "size and significance of coverage."
Source: Prepared by legislative auditor's staff using information from LDI.

Three Requirements With No Information Available. According to LDI officials, "*the changes in the number of policies by territory and by class, including age and sex in each territory*" cannot be tracked easily in the aggregate by territories and class definitions. However, if LDI had to report the changes in the number of policies by parish, it would be more feasible. LDI officials suggested that territory and classifications such as age and sex criteria be removed from the reporting requirement because the effort to report it would be too great. Furthermore, LDI questions the usefulness of tracking how these statistics change over time. In addition, LDI does not collect, nor are insurance companies required to submit, sufficient information to report on "*the volume of cancellations and non-renewals*" and "*the number of new insured and non-renewed insured.*" Some of this type of information would be considered confidential and proprietary to a business and could be damaging to the business if it was made public.

Results of Analysis of Reporting Requirements With Available Data

We analyzed data for the four reporting requirements where data were readily available. The analysis represents potential reporting information LDI could use to fulfill its reporting requirements. We used data from the last five years, 2000 through 2004 for our analyses, when available. If data for all five years were not readily available, then we used the data that were available, which was usually just for 2004, subsequent to the approval of flexible rating. We analyzed data for both private passenger automobile and homeowner coverages as shown in Exhibits 10 through 14.

Exhibit 10
Extent and Nature of Competition - 2000-2004

	Private Automobile		Homeowners	
Year	Number of Insurers With Written Premium	Percentage Change	Number of Insurers With Written Premium	Percentage Change
2000	183	N/A	114	N/A
2001	169	-7.7%	105	-7.9%
2002	163	-3.6%	103	-1.9%
2003	165	+1.2%	100	-2.9%
2004	156	-5.5%	91	-9.0%

Source: Prepared by legislative auditor's staff using NAIC reports provided by LDI. This information can also be presented by individual insurer; however, we summarized the results of the information in this table for report purposes.

Exhibit 11
Size and Significance of Coverage - 2000-2004

Year	Total P&C[1] Premiums	Automobile Premiums	Percentage Change in Premiums	Homeowner Premiums	Percentage Change in Premiums
2000	$5,188,644,333	$2,087,836,721	N/A	$631,862,055	N/A
2001	$5,744,162,644	$2,215,608,358	6.12%	$676,445,439	7.06%
2002	$6,521,049,152	$2,478,525,672	11.87%	$764,886,600	13.07%
2003	$7,252,523,828	$2,813,411,225	13.51%	$882,900,280	15.43%
2004	$7,443,602,210	$2,932,650,168	4.24%	$925,021,756	4.77%

Source: Prepared by legislative auditor's staff using documentation provided by LDI. This information can also be broken down by line of business and presented by individual insurer; however, we summarized the results of the information in this table for report purposes.

[1] Total P&C premiums include commercial lines of business as well as automobile and homeowners. Commercial lines of business are part of the property and casualty insurance group but are no longer eligible for flexible rating because they were deregulated in January 2005 as a result of R.S. 22:1401.1.

Exhibit 12
Level and Range of Rate Changes
Private Passenger Automobile - 2000-2004

Year	Decreases Approved	Increases Approved	Total Changes Approved	Average Increase/(Decrease)
2000	16	31	47	+.63%
2001	7	50	57	+6.78%
2002	2	60	62	+10.27%
2003	5	54	59	+7.12%
2004	13	45	58	+1.07%

Source: Prepared by legislative auditor's staff using documentation provided by LDI. This information can also be presented by individual insurer; however, we summarized the results of the information in this table for report purposes.

Exhibit 13
Level and Range of Rate Changes
Homeowners - 2000-2004

Year	Decreases Approved	Increases Approved	Total Changes Approved	Average Increase/(Decrease)
2000	8	11	19	+3.87%
2001	3	27	30	+5.40%
2002	3	32	35	+12.00%
2003	3	28	31	+8.49%
2004	3	31	34	+10.42%

Source: Prepared by legislative auditor's staff using documentation provided by LDI. This information can also be presented by individual insurer; however, we summarized the results of the information in this table for report purposes.

Exhibit 14 Property and Casualty Consumer Complaints - 2000-2004		
Year	**Number of Complaints**	**Percentage Change**
2000	N/A	-
2001	874	-
2002	2,113	+141.8%
2003	2,353	+11.4%
2004	2,016	-14.3%
Source: Prepared by legislative auditor's staff using documentation provided by LDI. This information can also be presented by individual insurer a number of insured to complaint ratio; however, we summarized the results of the information in this table for report purposes.		

Any Changes in the Insurance Industry as Identified by the Reporting Requirements Cannot Be Solely Attributable to the Flexible Rating Program

The reporting requirements outlined in state law are supposed to measure the impact of the Flexible Rating Program on P&C insurance, including insurance rates. However, LDI will not be able to attribute all changes shown by the reporting requirements solely to flexible rating because of many external factors, as outlined in Exhibit 15 below. Therefore, neither positive nor negative changes in competition and/or rates for insurance providers can be contributed solely to flexible rating.

Exhibit 15 Factors That Affect Insurance Rates and Competition		
Marketing Strategies	Driver Age	Insurance-to-Value Programs
Economy	Consumer Education	Changes in Housing Stock
Weather	Legislative Reforms	Corporate Infrastructure
Vehicle Construction	Maturing Population	Coverage Limits
Driver Education	Safety Programs	Investment Returns
Changes in Employment Class	Enforcement Efforts Deductibles	Changes in Vehicle Stock Deductibles
Source: Prepared by legislative auditor's staff using information from LDI.		

In addition to the factors listed above, the P&C insurance industry is characterized by periods of soft market conditions, in which premium rates are stable or falling and insurance is readily available, and by periods of hard market conditions, where rates rise and coverage may be more difficult to find and insurers' profits increase. A dominant factor in the P&C insurance cycle is intense competition within the industry. Premium rates drop as insurance companies compete vigorously to increase market share. As the market softens to the point that profits diminish or vanish completely, the capital needed to underwrite new business is depleted. In the up phase of the cycle, competition is less intense, underwriting standards become more stringent, the supply of insurance is limited because of the depletion of capital and, as a result, premiums rise. The prospect of higher profits draws more capital into the marketplace leading to more competition and the inevitable down phase of the cycle. Therefore, any changes between 2004 and 2008 could also be the result of the insurance industry shifting from a hard cycle to a soft cycle or vice-versa.

We spoke with LDI senior management and they agree that LDI cannot solely attribute changes in rates and competition to the creation and implementation of flexible rating.

Recommendation 8: LDI should formally inform the legislature of the limitations that exist when trying to attribute changes in rates and competition solely to Flexible Rating, prior to issuing its report in 2008.

LDI's Response: We concur with the recommendation. The LDI will contact the Legislature prior to the 2006 regular session to discuss the association of external measures solely to flexible rating's implementation.

SCOPE AND METHODOLOGY

We conducted this performance audit under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended. All performance audits are conducted in accordance with generally accepted governmental auditing standards as promulgated by the Comptroller General of the United States.

Audit Scope

This audit focused on the Flexible Rating Program administered by LID's Market Compliance Division. The audit covered the flexible rating program from January 1, 2004, to December 31, 2004. We also used information from previous years and other programs to answer the following objectives:

- Determine if LDI administers the flexible rating program to ensure compliance with legal requirements
- Determine if the flexible rating program is more efficient than the LIRC prior approval process
- Determine if LDI will be able to report the impact of flexible rating on insurance rates and competition as required in 2008

Methodology

To gain an understanding of insurance rating in Louisiana, we performed the following procedures:

- Researched state laws, rules, and regulations
- Analyzed LDI's current funding and staffing resources
- Reviewed LDI's Internet site
- Interviewed administrative and rating staff at LDI's headquarters
- Obtained information from various external sources

To obtain information on whether the Flexible Rating Program is administered so that the program is in compliance with legal requirements and that processes are efficient, we performed the following procedures:

- Obtained copies of certain information systems maintained by LDI and analyzed information relevant to the Flexible Rating Program and also obtained data from LIRC prior approval process to use as a benchmark during certain comparisons

- Reviewed rate request filings and data from LDI and compared it to information from the NAIC to determine if LDI is verifying premiums used in rate calculations

- Reviewed procedures and information from LDI to see if the rates that were approved are actually the rates that are implemented by the insurance companies

- Interviewed appropriate LDI staff to obtain information regarding intent and administration of the Flexible Rating Program

- Surveyed LDI staff and obtained and analyzed information from LDI's information systems, Complaint Department, and the NAIC to determine if LDI will be able to meet its 2008 reporting requirements

MANAGEMENT'S RESPONSE

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November 28, 2005

Mr. David K. Greer, CPA
Director of Performance Audit and Assistant Legislative Auditor
1600 North Third Street
Post Office Box 94397
Baton Rouge, LA 70804-9397

Re: *Response to the Confidential Draft of the Audit Report on the Flexible Rating System*

Dear Mr. Greer:

The Department of Insurance appreciates the opportunity to comment on the audit findings regarding the Flexible Rating System. Though we agree, in general, with the audit findings, we offer the following comments regarding the audit report and its findings:

Page 7: Under "Organization," the listing of three types of insurance lines is not comprehensive. We suggest that wording be revised to cover all types of property and casualty insurance. For example:

> "Property and casualty includes two primary types of insurance lines of business. These primary types of business are personal lines and commercial lines. Personal lines include homeowners, mobile home, private passenger automobile, recreational vehicle, personal umbrella, etc. Commercial lines include all lines that are not personal lines."

Page 8: Under "Rate Changes in Louisiana," it is stated that "there are currently two ways for insurance providers in Louisiana to file for a rate change." We would like to make two points of clarification.

First, we want to emphasize that this statement is relative to the audit scope that covers flexible rating from January 1, 2004 through December 31, 2004.

Second, we want to more accurately portray the filing options that were available to an insurer.

- During the January 1, 2004 through December 31, 2004 timeframe these options (documented, in part, by statutory reference) were available to an insurer when filing rates (unless specified, the option is available for all lines of business):

1. LRS 22:1401(I), 1407(A)(1) and 1407(C): Authorizes the Louisiana Insurance Rating Commission ("LIRC") to approve all applications for rates.
2. LRS 22:1401(J)(2) and (3): Defines the filing process known as "flexible rating."
3. LRS 22: 1407(E): Allows specific inland marine rates to be filed and used when filed.
4. LRS 22:1407(F): Allows, for certain lines and under certain conditions, rates to become effective without LIRC approval.
5. LRS 22:1407(K): Allows, for workers' compensation and under certain conditions, rates to be filed and used without LIRC approval.

- After January 1, 2005, a significant addition was introduced to the filing options described above:

  LRS 22:1401.1: Provides that all commercial filings be made to the Office of Property and Casualty for approval; the LIRC no longer has approval authority over commercial rates.

  Beginning January 1, 2005, only personal line filings are subject to either flexible rating or LIRC filing/approval processes.

Page 9: Exhibit 4, the second statement in the Approval row under the Prior Approvals column reads:

> "LIRC is not required to use actuary recommendation. The LIRC can approve a request that is not actuarially justified."

This statement may be misleading. The LIRC's authority [LRS 22:§1402] is "to promote the public welfare by regulating insurance rates to the end that they shall not be excessive, inadequate, or unfairly discriminatory ..." To meet this obligation, the LIRC must consider facts, historical experience, staff recommendations, and actuarial recommendations. Occasionally, the LIRC takes action (to approve, disapprove, or defer) on a filing where the LIRC believes circumstances exist which make it in the public's best interest to not act based solely on the actuarial recommendation. As a result, the LIRC can and has approved filings that are not actuarially justified and has, more frequently, disapproved filings that were actuarially justified.

We suggest this item read "LIRC is not required to use the actuary's recommendation. The LIRC can approve a request that is not actuarially justified or disapprove a request that is actuarially justified."

Page 13: The second paragraph, second sentence reads in part "The rate change request is only an estimate ..." We believe that the use of the word "only" is inappropriate. An estimate is what it is, an approximation representing the insurer's expectation as to the impact the filing will have on future revenue streams given a constant policyholder base. By nature an "estimate" is not exact. Use of the word "only" suggests that it is inaccurate and misleading, which we do not believe is the case or intent of the audit's comment.

Page 13: In the example provided in the second paragraph, we would point out that the Preferred Driver Program and Preferred Driver Gold Program's rates would be approved if they were actuarially justified. An important implication of this statement is that the two programs have mutually exclusive market niches. If they are not mutually exclusive, they would not have been approved in the first place as they would have created a rate structure that was unfairly discriminatory, i.e., produced different rates for identical risks.

Page 13: In the third paragraph and in Exhibit 7, we suggest that the audit comments clarify that the "+9.2%" is a statewide average rate change. It can be expected that an individual policy will experience a rate revision either greater or less than +9.2%, possibly by a large margin.

Page 14: The section titled "LDI Should Ensure that Accurate and Reliable Premiums are Used for the Actuarial Review Process" discusses accurate and reliable premiums. This section should be expanded to include reported premium, loss, and expense data. Both loss and expense data is as important as premium data and is more volatile. Not including them in efforts to ensure accuracy would be remiss on the LDI's part.

Page 15: Recommendation 1 - LDI should consider developing a process to verify premiums (reported by insurance companies in rate change requests) that it uses in its actuarial justification process since these premiums are the driving force behind rate change request approvals.

We agree with the recommendation and will look at means to ensure the accuracy of reported premium, loss, and expense data.

However, Recommendation 1 should be revised to include loss and expense data.

Note that we already verify many filing's expense data by comparing it to annual statement audited expense data. In a filing, expense data is usually countrywide or state data recorded on a calendar year ("CY") basis. Annual statement data is also derived from countrywide and state experience, by line. It is available directly from the annual statement and can be accessed via NAIC's ISITE database or from Best's Insurance Expense Exhibit report (LDI has a subscription).

To the extent that a filing uses data recorded on a calendar year basis, we can verify premium and loss information just as we do expense data. Unfortunately, filings seldom use calendar year data. Filings typically use calendar/accident year ("AY") and, occasionally, policy year ("PY") reporting. Neither of these data reportings, both of which are common actuarial methods to evaluate rates, allow for easy verification of the reported loss component.

To further complicate the audit of premium, loss, and expense data, a filing's scope may be a subset of coverages or programs included in a much broader audited annual statement line of business. For example, a filing for personal umbrella program is recorded in the annual statement as "other liability" which also includes many commercial liability lines. Therefore, using the annual statement to verify the accuracy of data reported in a filing for personal umbrella can not be performed by review of the annual statement line's data.

Page 15: Recommendation 2 - LDI should consider monitoring a more representative number of P&C policies to ensure that only approved rates are implemented by insurance providers.

We agree in principal with Recommendation 2 but we believe that we already audit the rates implemented by companies sufficiently to protect the public. We would be willing to expand our audit scope if expanding the monitoring of P&C policies can be performed with existing resources.

Many years ago, we audited all P&C policies, an effort that utilized the resources of up to 300 staffers. Though technological advancements may assist in the automation of the effort, an attempt to audit all regulated policies would require a significant increase in staff. Over the years the LDI has scaled back the individual audit practice and a few years ago consciously stopped the practice altogether. We do not believe the public has been ill served by our decision to cease all-encompassing policy audits.

The LDI believes that it currently and sufficiently monitors policies to determine if only approved rates were implemented by insurers. The LDI monitors rates implemented by insurers in two ways. First, we audit the accuracy of every complaint whose underlying cause of concern was rates. This figure produces a sample across the industry approximating 650 audited policies. Second, when circumstances point to a company that may be transacting business in violation of our unfair trade practices statutes, the LDI will perform larger scale, stratified and random market conduct review of just that company's book of business. The LDI believes this two front audit process adequately protects the public.

Page 15: Recommendation 3 - LDI should explore ways to expand the scope of its rate audits to include a sample of similar policies when inaccurate rates are detected within a questioned policy.

We agree in principal with Recommendation 3 but we believe that we already perform this expansion of scope when inaccurate rates are detected within a single policy.

As outlined in the discussion to Recommendation 2 above, when our monitoring of rates implemented by insurance companies uncovers a problem that appears to be systematic (more than a typographical error), we request that the company send a random sample of policies (up to 100) for a more in depth audit. If this audit continues to suggest that a widespread and systematic use of unapproved rates underlies the detected inaccurate rates, we will take appropriate action by issuing an order-to-show-cause or turning the matter over to the LDI's market conduct division for further review.

Page 16: Note that the formal name of the "Agenda" is the Comprehensive Agenda Tracking System, or "CATs."

Page 16: Recommendation 4 - LDI should add the additional necessary fields to its Agenda database in order to capture all programmatic data for flexible rating.

We concur with Recommendation 4.

A project was currently in the planning stages and an RFP was being prepared to add additional fields to CATs. . This project is currently on hold due to hurricane related matters. These new fields will make CATs the only database required by the LDI for recording and reporting of all filing activity, both flexible rating and all other filing types. With the proposed additions, the report feature of CATs will be able to analyze all internal, external, and legislative report requirements.

Page 16: Recommendation 5 - Once the necessary fields are added to the Agenda database, LDI should use this centralized source of data to report on the impact of the Flexible Rating Program.

We concur with Recommendation 5.

See comments to Recommendation 4 above.

Page 18: Recommendation 6 - LDI should consider developing and implementing procedures to ensure that all rate and rule change request filed through the Flexible Rating Program are reviewed within 30 days.

We agree in principal with Recommendation 6.

The LDI makes every effort to complete the rate review within the allotted 30 days. However, it is not always within the LDI's control to "ensure" the filing will be completed during the 30 day waiting period. For example, if the LDI promptly reviews a filing within a few days of receipt and requests additional information necessary to determine compliance, the insurer may not respond quickly (maybe on day 29). In this case it is likely that the 30 day period may expire before the LDI can complete its review.

In situations where it appears the 30 day waiting period will expire before a response is received from the insurer, the LDI will make every effort to contact the company to gain such response. If LDI's effort to contact the insurer fails, LDI staff will request the actuary disapprove the filing because it is not adequately supported.

The LDI wants to emphasize that a rate filing that is deemed approved because the LDI's review (by the actuary) was not completed within the allotted 30 days does not prevent the LDI from subsequently disapproving the rates if found not to be actuarially justified. In practice, there have been few disapprovals after the 30 day waiting period. In all cases, however, the insurer did not implement the deemed rate revision before the actuarial staff notified them of the subsequent disapproval.

Page 18: We suggest the section titled "LDI Should Consider Requiring All Rate Changes ..." be changed to "Legislature Should Consider ..."

Page 18: In the paragraph just above the number reasons should read "three reasons" not "two reasons."

Page 19: Matter for Legislative Consideration – The legislature may wish to consider changing the law to require all rate changes within the flex band of +/-10% that are eligible for flexible rating to be filed through flexible rating process.

We concur with Matter for Legislative Consideration.

Page 20: Recommendation 7 - LDI should work with the legislature to clearly define the 2008 reporting requirements for Flexible Rating.

We concur with Recommendation 7.

The LDI will contact the Legislature prior to the 2006 regular session to discuss the difficulties LDI has with reporting on a few of the statutory requirements. We agree with the audit's assessment, as laid out in Exhibit 9 and subsequent discussion:

- "Business written by each insurer" is duplicative of "Extent and nature of competition."
- "Changes in the number of policies by territory and by class including age and sex in each territory" will be very difficult to report upon. This information is not currently available to the LDI. The LDI expects that it would require measurable resources to collect and maintain. Companies utilize a variety of classification systems that have similarities but often contain many unique differences. Aggregating this data to report statewide would, in itself, be problematic. Further, the LDI questions the usefulness of such a report as we do not expect class data on an aggregated statewide basis to change much over time. Lastly, if the intent is to report on class exposure changes at the individual insurer level, there will be confidentiality challenges that the LDI is reluctant to undertake.
- "Volume of cancellations and non-renewals" will be very difficult to report upon. This information is not currently available to the LDI. See comments above regarding some issues surrounding reporting this data.

- "Number of new insured and non-renewed insureds" will be very difficult to report upon. This information is not currently available to the LDI. See comments above regarding some issues surrounding reporting this data.

Page 25: Recommendation 8 - LDI should formally inform the legislature of the limitations that exist when trying to attribute changes in rates and competition solely to Flexible Rating, prior to issuing its report in 2008.

We concur with Recommendation 8.

The LDI will contact the Legislature prior to the 2006 regular session to discuss the association of external measures solely to flexible rating's implementation.

All Pages: Throughout the report there are minor formatting, grammatical, and spelling issues.

Please call me at 342-5423 if you have any questions or would like to discuss our responses and/or corrective actions.

Sincerely,

J. Robert Wooley
Commissioner of Insurance

JRW/RP/arq

Enclosure

CONFIDENTIAL

Office of the Legislative Auditor – Performance Audit Division
Checklist for Audit Recommendations

Instructions to audited agency: Please check the appropriate box below for each recommendation. A summary of your response for each recommendation will be included in the body of the report. The entire text of your response will be included as an appendix to the audit report.

RECOMMENDATION(S)	AGREE	PARTIALLY AGREE	DISAGREE
Recommendation 1: LDI should consider developing a process to verify premiums (reported by insurance companies in rate change requests) that it uses in its actuarial justification process since these premiums are the driving force behind rate change request approvals.	√		
Recommendation 2: LDI should consider monitoring a more representative number of P&C policies to ensure that only approved rates are implemented by insurance providers.		√	
Recommendation 3: LDI should explore ways to expand the scope of its rate audits to include a sample of similar policies when inaccurate rates are detected within a questioned policy.		√	
Recommendation 4: LDI should add the additional necessary fields to its Agenda database in order to capture all programmatic data for flexible rating.	√		

Recommendation 5: Once the necessary fields are added to the Agenda database, LDI should use this centralized source of data to report on the impact of the Flexible Rating Program.	√		
Recommendation 6: LDI should consider developing and implementing procedures to ensure that all rate and rule change request filed through the Flexible Rating Program are reviewed within 30 days.		√	
Recommendation 7: LDI should work with the legislature to clearly define the 2008 reporting requirements for Flexible Rating.	√		
Recommendation 8: LDI should formally inform the legislature of the limitations that exist when trying to attribute changes in rates and competition solely to Flexible Rating, prior to issuing its report in 2008.	√		