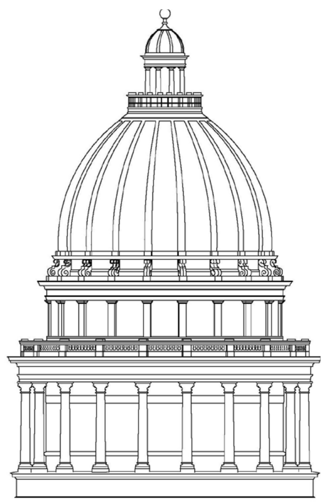
REPORT TO THE

UTAH LEGISLATURE

Number 2022-09



An In-Depth Budget Review of the Utah Insurance Department

September 2022

Office of the
LEGISLATIVE AUDITOR GENERAL
State of Utah

Office of the Legislative Auditor General

Kade R. Minchey, Legislative Auditor General

W315 House Building State Capitol Complex | Salt Lake City, UT 84114 | Phone: 801.538.1033

September 20, 2022

The Utah State Legislature:

Transmitted herewith is our report, An In-Depth Budget Review of the Utah Insurance Department (Report #2022-09). An audit summary is found at the front of the report. The objectives and scope of the audit are explained in the Introduction.

We will be happy to meet with appropriate legislative committees, individual legislators, and other state officials to discuss any items contained in the report in order to facilitate the implementation of the recommendations.

Sincerely,

Kade Minchey

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Auditor General
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IN-DEPTH BUDGET REVIEW

Utah Insurance Department

AUDIT REQUEST

The Legislative Audit Subcommittee selected the Utah Insurance Department (UID) to be audited as part of an annual in-depth budget review, which includes a review of agency funding and performance.

As part of the risk assessment, we identified specific concerns in two divisions within UID: the Captive Insurance Division and the Insurance Fraud Division.

BACKGROUND

The Utah Insurance Department is the state agency responsible for the regulation of the insurance industry.

Because the vast majority of insurance in the United States is regulated at the state-level, UID is a member of a highly coordinated, state-based national system of regulators.

UID is made up of six divisions that help regulate insurance. This audit focuses on two:

- The Captive Insurance Division, which regulates and promotes the captive insurance industry, and
- The Insurance Fraud Division, which investigates and prosecutes insurance fraud.

KEY FINDINGS

- The Captive Insurance Division has embraced its role in promotion, but can improve its role as a regulator.
- The level of economic benefit that was a driving factor in permitting captive insurance has not been realized.
- Some important incidents of fraud go uninvestigated by the Insurance Fraud Division.

RECOMMENDATIONS

- We recommend the Legislature consider whether it is appropriate for the Captive Insurance Division to promote the industry given its role as regulator.
- We recommend that the Captive Insurance Division establish policies and procedures to better regulate the captive insurance industry.
- We recommend the Captive Insurance Division enforce requirements that directly lead to economic benefit.
- We recommend the Insurance Fraud Division provide antifraud education programs for insurers and the public.

Utah Code Directs Regulators to Promote the Captive Insurance Industry, Creating the Need to Manage Possible Conflict of Interest

Two statutory requirements for the Captive Insurance Division—to regulate and to promote the captive industry—could interfere with the division's ability to regulate effectively and equitably and could lead to the perception of a conflict of interest.

Summary continues on back >>

The Captive Insurance Division Lacks Policies to Dictate How to Address Higher-Risk Captives

The Captive Insurance Division lacks policies and procedures. As a result, it is not always evident why analysts make certain decisions about regulating captives. We believe that establishing formal policies and procedures will help alleviate the perception of a conflict of interest.

The Reported Economic Benefit To the State is Questionable

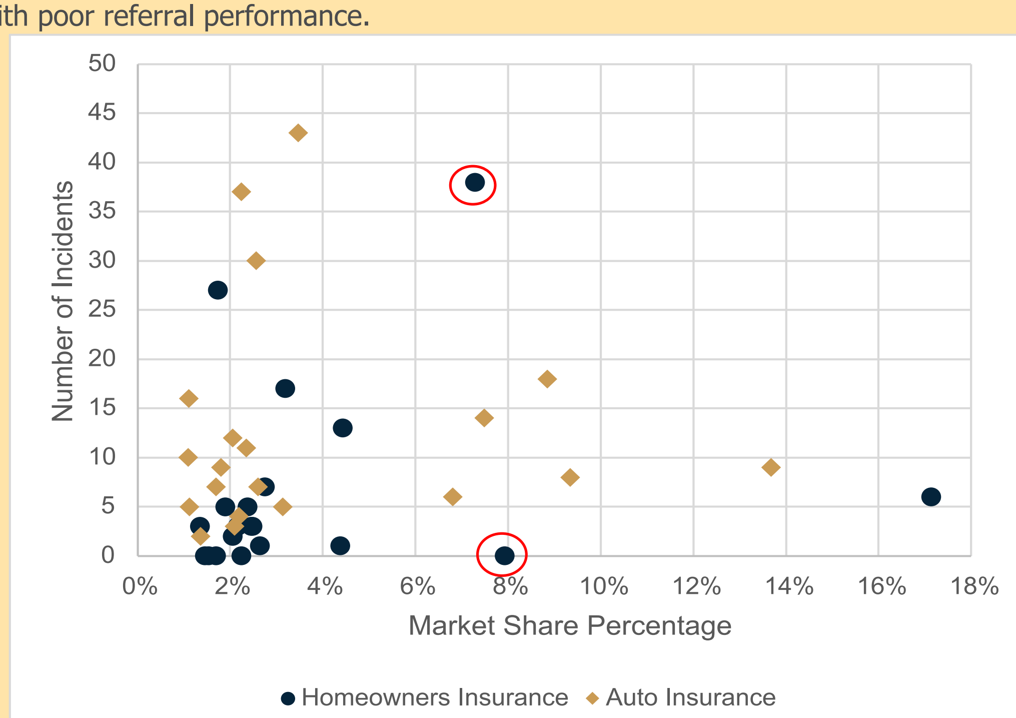
Captive insurance has not created the economic benefit originally stated. Economic benefit was one of the driving factors when captive insurance was first authorized in 2003. We found that even the modest economic benefit being reported to the division is likely inaccurate due to incorrect r eporting. If the Legislatur e is concerned about the lower than estimated economic benefit, some changes could result in addi tional economic benefit to the state. The Captive Insurance Division could incr ease some activities and enforcement that gener ates economic benefit and funds the division.

Insurance Fraud Division Lacks Prevention and Education Activities That Could Increase Its Effectiveness

IFD should seek to assess insurers and provide citizen education to prevent fraud. The ability to substantially increase consistency and strengthen antifraud activities is well worth the time.

Our Analyses Show That Insurance Companies' Referral Practices Vary

There are companies who are likely not reporting all instances of suspected insurance fraud as required by statute. The two companies circled provide an example of companies with similar market shares that have a wide disparity in their reporting rate. We recommend that IFD perform targeted education to companies with poor referral performance.



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Chapter I
Introduction

The Utah Insurance Department (UID, or the department) is the state-level agency responsible for the regulation of the insurance industry. Because the vast majority of insurance is regulated on the state-level, UID is a member of a highly coordinated state-based national system of regulators.

This chapter contains the following:

- A description of the statutory mandate for our office to conduct an in-depth budget review
- A summary of UID's structure, funding and expenditures over the past five fiscal years
- A brief follow-up to the 2013 audit *A Performance Audit of the Market Conduct Division*, as directed by statue.

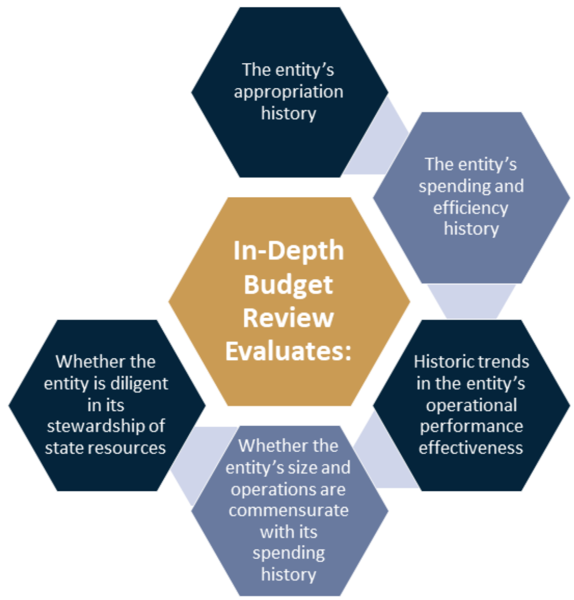
In-Depth Budget Reviews Utilize the Agency's Budget to Assess Risk

The Legislative Audit Subcommittee selected the Utah Insurance Department to be audited as part of an annual in-depth budget review, which includes a review of agency funding and performance. To complete this review, we conducted a risk assessment of the department's divisions, revenues, and expenditures from fiscal years 2017 through 2021. The chapters in this report reflect the results of our risk assessment as well as statutory requirements for in-depth budget reviews.

We conducted a risk assessment of UID's divisions, revenues, and expenditures.

Utah Code 36-12-15.1 requires the Office of the Legislative Auditor General to audit the appropriations of at least one entity annually. The intent of these audits, as outlined in statute, is to determine how efficiently and effectively the entity has used its appropriated funding. Statutory requirements for in-depth budget reviews are summarized in Figure 1.1.

Figure 1.1 An In-Depth Budget Reviews Evaluates Appropriations, Spending, and Performance. The following chart summarizes requirements specified in statute.



As part of this audit, we performed a risk-based review that identified specific concerns in two divisions within UID. These findings are discussed in subsequent chapters.

Insurance Is Regulated at the State Level

The National Association of Insurance Commissioners (NAIC) coordinates states' regulatory efforts, meaning insurance is regulated at the state level.

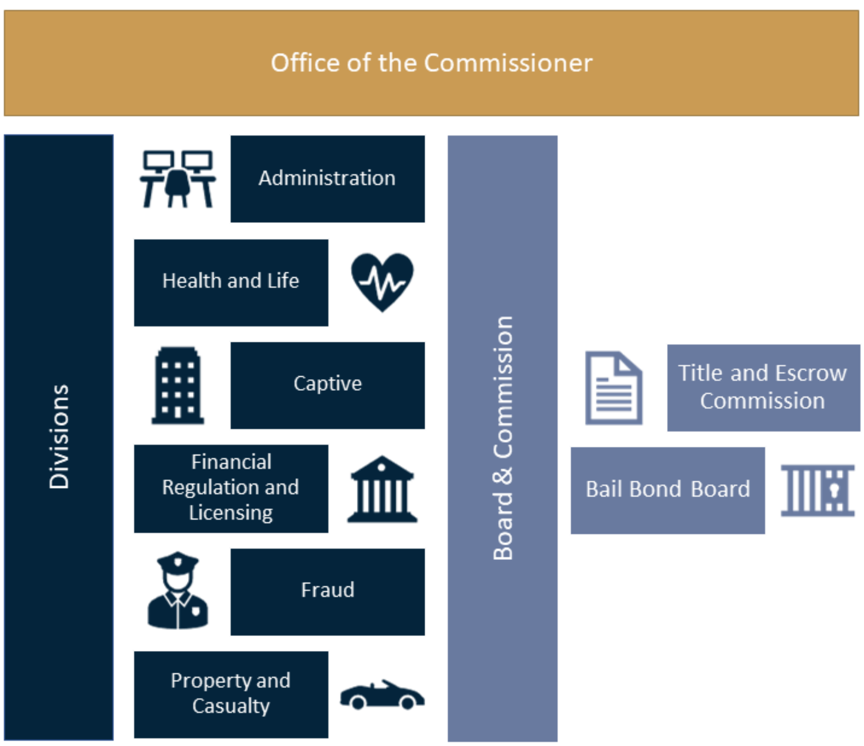
The insurance industry is regulated by individual states and territories. In 1945, the McCarran-Ferguson Act delegated the regulation and taxation of "the business of insurance" to the states. Since the business of insurance regularly crosses state lines, it is essential to regulate the industry consistently. The National Association of Insurance Commissioners (NAIC) is governed by the chief insurance regulators of all fifty states, the District of Columbia, and five US territories. NAIC also serves (in part) as the association responsible for coordinating regulatory efforts. UID participates in numerous NAIC committees, working groups, and task forces to address emerging and on-going issues.

UID's Divisions Are Funded Primarily Through the Industry

The Utah Insurance Department is almost fully funded by fees and forfeitures assessed on the insurance industry—companies and producers—as well as fines assessed on those who commit insurance fraud. The primary source of funding is the Insurance Department Restricted Account, which lapses unspent revenue to the General Fund. The department received only $10,000 from the General Fund in 2021.

The department is comprised of six divisions, one board, and one commission. Figure 1.2 provides an overview of UID's structure.

Figure 1.2 UID Divisions and Boards Fulfill Varying Needs of Regulation. Each division is responsible for regulating a different aspect of the insurance industry.



Source: UID

- **Administration—**Administrative functions such as budgeting and accounting

- **Health and Life—**Consumer services such as pricing, reviewing required filings from insurance companies and consumer inquiries, complaints, and recoveries
- **Property and Casualty—**Consumer services such as pricing, reviewing required filings from insurance companies and consumer inquiries and complaints
- **Captive Insurance—**Regulates and promotes the captive insurance industry
- **Financial Regulation and Licensing—**Conducts financial examinations of traditional insurance companies located in the state and licenses companies/insurers and producers
- **Insurance Fraud—**Conducts insurance fraud investigations and prosecutes violators

The Majority of UID Funding Comes from Fees Assessed on the Industry

UID receives most of its funding from fees assessed on the insurance industry. Figure 1.3 shows that less than 1 percent of the department's funding comes from the General Fund.

Figure 1.3 UID Has Multiple Sources of Funding. The vast majority of its funding comes from fees assessed on the industry.

Funding Source	2021 Funding	Percentage of UID Funding
General Fund	$10,000	0.1%
Federal Fund	384,600	2.4%
Dedicated Credits	481,800	3.0%
Fees	$15,375,400	94.9%

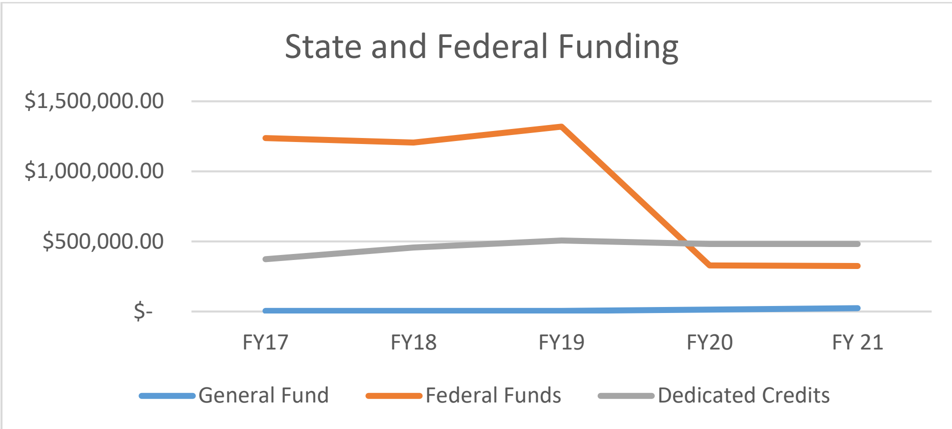
Source: Compendium of Budget Information (COBI)

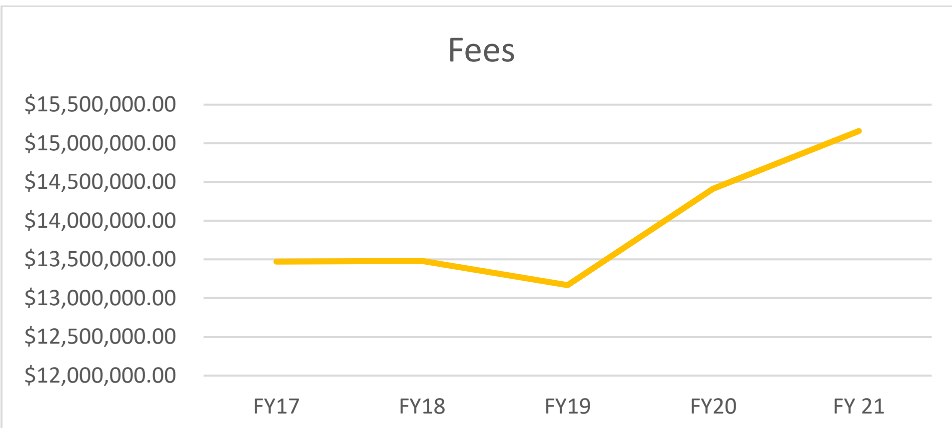
Money that exceeds the amount appropriated to the department lapses to the general fund.

The majority of the fees that fund the division are assessed on the industry and are placed into the Insurance Department Restricted Account. At the end of each fiscal year, any money that exceeds money appropriated to the department is deposited into the General Fund. Another fund that receives significant amounts of revenue each year from fees is the Captive Insurance Restricted Account. Although the fund is non-lapsing, monies in excess of $1,450,000 lapse to the General Fund.

UID's funding decreased from fiscal year 2018 to 2019 but has since increased modestly. Figure 1.4 shows funding patterns for UID from fiscal year 2017 to 2021.

Figure 1.4 Five Years of Funding. Funding from the industry (i.e., fees) has increased, while funding from state and federal funds has decreased.





Source: COBI

Total UID funding has increased modestly over the past five fiscal years. A decrease in federal funding was met with an increase in funding from fees.

Department Expenditures Have Fluctuated Over the Past Five Years

Overall, expenditures have increased over the past 5 fiscal years. Figure 1.5 shows that the majority of UID's expenses are for personnel services.

Figure 1.5 UID Expenditures, by Category, for the Past Five Fiscal Years. Compared with other departments' spending, UID's spending on out-of-state travel has typically been high and is due to the nature of insurance regulation.

	2017	2018	2019	2020	2021
Personnel Services	$8,200,749	8,917,056	9,136,691	10,005,109	$9,888,779
In-State Travel	$7,800	10,453	15,308	5,796	$4,680
Out-of-State Travel	$160,988	149,489	156,943	85,943	$156*
Current Expense	$1,846,645	1,461,853	1,683,263	1,958,907	$1,948,260
Other	$2,102,502	1,824,980	999,693	1,533,692	$1,735,413
Total	**$12,318,684**	**12,363,832**	**11,991,897**	**13,589,447**	**$13,577,288**

Source: FINET
**Low out-of-state travel costs due to COVID-19*

Coordination with other states through the department's membership in the NAIC leads to higher out-of-state travel costs.

The department typically spends heavily on out-of-state travel. A significant portion of this travel is to attend NAIC conferences and working groups. The conferences typically involve many working sessions because the states aim to be highly coordinated in the regulation of insurance. Utah Code 31A-2-210 states, "The Insurance Department shall maintain relations with the commissioners of other states and shall participate in the activities and affairs of the National Association of Insurance Commissioners and other organizations." Out-of-state travel expenses also include the cost for UID examiners to travel to other states to conduct joint examinations in cases where an insurance company has headquarters in multiple states. Out-of-state travel expenses also include travel for Captive Division employees to attend conferences to promote Utah as a captive destination. Chapter II discusses this travel in detail.

Since the COVID-19 pandemic, NAIC has held virtual and hybrid conferences. Going forward, we would expect to see UID take advantage of opportunities to attend virtual conferences when it's practical.

The Legislature Restored Some FTEs in the Most Recent Legislative Session

During the 2020 Legislative Special Session, the Legislature eliminated four full-time equivalents (FTEs) from UID. Three of the four positions were restored during the 2022 Legislative General Session, as shown in Figure 1.6.

Three of the four positions eliminated during the 2020 Legislative Special Session were restored in the most recent General Session.

Figure 1.6 Full-Time Equivalents in UID Have Remained Fairly Constant. FTEs dipped in 2020 because of pandemic-related budget cuts.

	2017	2018	2019	2020	2021
Administration	61.3	61.8	62.9	64.6	61.2
Insurance Fraud	13.6	14.5	13.7	13.9	13.7
Title Insurance	0.8	0.7	0.5	1.0	1.0
Captive Insurance	8.6	10.7	11.0	11.0	11.0
Health Insurance Actuary	0.0	0.5	1.0	1.0	1.0
Fed Health Insurance Premium Review Grant	3.0	2.2	0.0	0.0	0.0
Total	**87.3**	**90.3**	**89.1**	**91.5**	**87.9**

Source: FINET

Figure 1.6 shows that most of the FTEs fall under the Administration appropriation. Administration includes four divisions: the Financial Regulation and Licensing Division, the Health and Life Division, the Property and Casualty Division[1], and the Administration Division. The Captive Insurance Division grew by two to three FTEs during this time.

A Follow-up with the Market Conduct Sections Found Recommendations were Implemented

Utah Code 36-12-15(10) advises the Office of the Legislative Auditor General to ensure that all recommendations from previous audits have been implemented. In 2013, our office released *A Performance Audit of the Utah Insurance Department.*[2] The audit

[1] Except the FTE dedicated to title insurance regulation.

[2] We also conducted a follow-up of 2009-09 *A Performance Audit of the Insurance Fraud Division*, which is found in Chapter IV of this report.

The Health and Life and Property and Casualty market conduct sections are the administrative enforcement arm of the department.

focused on the Market Conduct Division, which no longer exists and whose functions are now fulfilled by the Health and Life and Property and Casualty divisions. Market conduct sections within these two divisions serve as the administrative enforcement arm of the department. Consumers, government entities, and other licensees can bring complaints against insurance licensees to the appropriate division for investigation and possible forfeitures. The 2013 audit found deficiencies such as ineffective communications with licensees, insufficient documentation, and a lack of policies and procedures which, in part, led to inconsistencies in assigned monetary forfeitures.

We determined that both divisions have improved communication, documentation, and consistency.

We performed a limited follow-up to the audit and found that the division has implemented the recommendations from the 2013 audit report. Both divisions report that market conduct analysts formally reach out to both parties at least twice and keep parties updated through email and phone calls throughout the investigation. Analysts document and update case statuses weekly and expectations for time to closure are based on a complexity scoresheet. The market conduct sections also utilize a workflow chart to ensure that decisions are consistent and documentation is complete. Additionally, both divisions utilize a penalty worksheet and accepted mitigating factors for a reduction to the penalty are documented in policy.

The only recommendation that was not fully implemented was that of prioritizing cases. The divisions opted not to implement this recommendation because they investigate every case. However, cases are prioritized if they are time sensitive. Based on our follow-up review, we are satisfied with the actions taken by the divisions to implement previous recommendations.

Audit Scope and Objectives

This audit was conducted in accordance with ***Utah Code*** 36-12-15.1, which authorizes in-depth budget reviews of state entities as prioritized by the Legislative Audit Subcommittee. Accordingly, the objective of this audit is to assess UID's budget and divisions for risk. Chapter I of this audit report has addressed UID's purpose, structure, funding, and expenditures. Based on issues identified in our risk assessment and budget review process, the scope of the remaining chapters is as follows:

- **Chapter II** discusses the potential conflict of interest that the Captive Insurance Division faces and the absence of policies and procedures.

- **Chapter III** discusses the economic impact of captive insurance on the state of Utah.

- **Chapter IV** discusses improvements that the Insurance Fraud Division should make, along with possible policy options the Legislature could consider to better detect and prevent insurance fraud.

Chapter II
Better Policies Are Needed to Reduce the Perception of Conflict of Interest in the Captive Insurance Division

The Captive Insurance Division (captive division, the division) is required by statute to regulate all captive insurance companies domiciled in Utah. Statute also directs the division to promote the captive industry. These two statutory requirements—to regulate and to promote the captive industry—could interfere with the division's ability to regulate effectively and equitably and could lead to the perception of a conflict of interest. One way to control for this perception is for the Captive Insurance Division to create and follow policies and procedures for the regulation of all captives. Currently, the division lacks policies and procedures and it is unclear if all captives are treated equally.

A Captive Insurance Company Insures the Risks of Its Parent Company

A captive insurance company ("captive") is an insurance company formed and incorporated by a parent company or companies to insure some or all of the parent company's risk. Premium that is not used to pay insurance claims filed by the parent company is retained by the captive and reverts to the parent company at the time of the dissolution of the captive. While the captive may have to pay some taxes at the time of dissolution, there are several tax advantages that can be realized by the captive during its lifetime.

Captive premiums not used to pay claims revert to the parent company at the time of dissolution.

Utah Code Directs Regulators to Promote the Captive Insurance Industry, Creating the Need to Manage Possible Conflict of Interest

Utah Code 31A-3-304 authorizes the Captive Insurance Division to utilize money from the captive insurance restricted account to "promote the captive insurance industry in Utah." We are concerned that engaging in promotional activities—by those who are tasked with regulating the industry—creates the perception of a conflict of interest.

It is imperative that the division properly manage the perception of a conflict of interest, which is amplified by the inherently close ties between the division and members of the industry. Changes to how the division operates may alleviate the perception of a conflict of interest.

The Captive Division Has Embraced its Role of Promotion, But Can Improve its Role as a Regulator

Division staff participate in promotional conferences around the country.

The Captive Insurance Division has embraced its role of promoting captive insurance. However, the division must do more to manage its activities by implementing clear policies. The Captive Insurance Division sends employees to annual conferences around the country for the captive insurance industry. In 2022, the division sponsored a conference in Las Vegas. The Utah Insurance Department was a major sponsor along with five other businesses that provide captive services. The cost of this sponsorship was $5,000. Only one other state's insurance department sponsored the event: The Oklahoma Insurance Department was a lanyard sponsor at a cost of $1,500.

In fiscal year 2019 (pre-pandemic), the division spent more than $55,000 to attend captive related conventions. Additionally, the division spent over $30,000 on out-of-state travel associated with conventions. It also spent money on advertising, especially during the pandemic years.

The Captive Division Has Inherently Close Ties with the Industry

Two former captive division directors work in the captive industry.

Due to the nature of the industry, members of the division are likely to have ties with some regulated entities and/or service providers. For example, conferences that the division participates in are also attended by businesses that provide captive services. Additionally, two former directors of the division are board members of numerous captive insurance companies. One of these former directors also runs a captive consulting business, which likely explains his position on so many boards of directors. The other former division director works for an approved[3] captive management firm that was

[3] Captive management firms assist captive owners in understanding the laws and rules of the state of Utah, and in managing the day-to-day operations of their captive insurance company.

also a sponsor of the Las Vegas conference mentioned above. While the Utah Insurance Department (UID) and the captive division cannot prevent former employees from being hired by the captive industry, it can establish policies regarding the interactions between division employees and businesses that provide captive services and advice.

The Division Should Have a Policy to Prohibit Recommending Specific Services to Captives

The division should create a policy to prevent analysts from making recommendations to captives regarding commissioning captive services. In our review, one analyst noted that he makes recommendations to perspective captives (when asked) about which captive manager to hire. We feel that it is not appropriate for state employees to make suggestions recommending one private company over another. This is also concerning because a different analyst that informed us that some captive managers are known to be more lenient than others, especially regarding captives that operate almost exclusively for tax purposes. It appears that other analysts also may be giving recommendations to perspective captives. For example, when reviewing captive managers by analyst, we observed patterns that intimate that other analysts may be suggesting specific captive managers when assisting a prospective captive. In addition to creating a policy to address this issue, we believe that having more regulatory policies and procedures in place would lessen the perception of a conflict of interest.

The division should create a policy against recommending specific businesses that provide captive services.

The Division Lacks Policies to Dictate How to Address Higher-Risk Captives

The Captive Insurance Division lacks policies and procedures. As a result, it is not always evident why analysts make certain decisions about regulating captives. Staff told us that some decisions are made based on instinct. This approach is particularly evident when the division decides whether or not to conduct a full-scope financial examination of a captive. We were told that the division has established several unwritten rules about which types of captives are given full examinations, but it does not appear that the division consistently follows these rules. This could result in allegations of unequal treatment of some captives or insufficient oversight of higher-risk captives. The division also lacks policies regarding non-compliance and disciplinary action. In addition, the captive division should establish criteria for approving captive requests that could impact the solvency of the company. We believe that establishing formal policies and procedures will help alleviate the perception of a conflict of interest.

There are Several Allowable Types of Captives in Utah

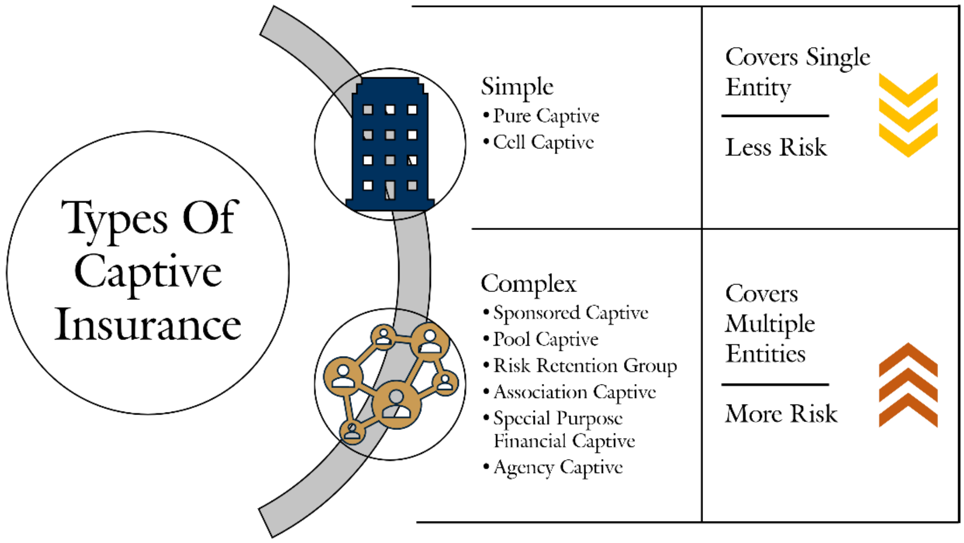
Companies determine what type of captive to form based on factors such as capitalization requirements, desired membership, and the ultimate purpose of the captive.

Because risk partially depends on the structure of the captive, we are providing a brief explanation of the types of captives that will be discussed in this chapter. Utah Code permits captives to be structured in several ways. Companies determine what type of captive to form based on factors such as capitalization requirements[4] desired membership, and the ultimate purpose of the captive. While 95 percent of captives in Utah are simple in structure, insuring only the risk of a parent company or affiliate, more complex captives are also regulated by the division.

Figure 2.1 summarizes allowable types of captives.

[4] Capitalization requirements refers to the minimum amount of cash or cash equivalent the captive is required to hold in reserve

Figure 2.1 There are several allowable forms of captives in Utah. Captives that we categorized as simple inherently carry less risk because insolvency typically affects only the parent company or affiliate. Captives we categorized as complex can impact multiple outside entities and therefore have greater risk.



The simplest structure of a captive is a pure captive in which a captive insures the risk of a single parent company or affiliate. Cell captives are similar, except they rely on a sponsor to fulfill capitalization requirements. More complex captives include the sponsor captive that supports multiple cells. Complex captives also include pool captives, which assume and redistribute risks from numerous captives to achieve diversification of risk. Often, captive managers will form a pool captive so its captives can diversify risk. An agency captive provides reinsurance[5] for a traditional insurance company. Because complex captives insure the risks of multiple entities and not just their own parent company, they may require a greater degree of oversight by the captive division.

Because complex captives insure the risks of multiple entities, they may require a greater degree of oversight.

The Division Should Establish a Policy Regarding Examinations and Exemptions

Utah Code 31A-37-502(1)(a) states, "the commissioner, or person appointed by the commissioner shall examine each captive insurance company in each five-year period." However, Utah Code 31A-37-

[5] Reinsurance is a way for insurance companies to transfer some risk to another insurance company.

The division conducts full-scope financial examinations of captives infrequently.

502(3) allows the commissioner to "accept a comprehensive annual independent audit, in lieu of an examination…" In practice, the division rarely conducts exams, conducting four in 2020 and one in 2021. Such infrequency represents a decrease from what was seen in earlier years. We were told by analysts that the decision to conduct a full-scope examination is determined in part, by the type of captive.

It is common for the division to waive full-scope examinations of simple captives.

It is common for the division to waive exams on simple captives because of the minimal risk to anyone besides the parent company. However, the division reported that it does not waive exams on complex captives due in part to the risk of insolvency to participants who do not have control over the financial well-being of the captive. This policy is not documented and our review of captive case files found that the division does not always follow it.

The division accepted two audits in lieu of full-scope examinations for a self-managed reinsurance captive.

The Division Waived Examinations for Several Complex Captives. We found five instances in which the annual audit was accepted in lieu of a full-scope examination. This occurred for one sponsor captive, two pool captives and one agency captive (twice). The agency captive received two separate audits-in-lieu despite also being self-managed—a situation that could create additional risk for internal controls. In 2018, an analyst assigned to the captive noted "The management of the captive appears to be lax." Yet in 2020, the division opted to accept an audit-in-lieu.

The Division Should Consider Whether a Captive Writes Higher Risk Lines of Insurance when Deciding Whether to Conduct an Exam. The division does not consider that some lines of insurance could be higher risk than others. While captives are not allowed to write health, life, personal automobile or homeowners insurance, they are permitted to write lines that could impact people unaffiliated with the captive. For example, we found several captives that wrote policies for medical malpractice or medical stop-loss. If the captive were to become insolvent and claims were made against the policy, payouts to victims could be affected.

Similar concerns arise with captives that administer warranty programs, worker's compensation deductible payments, or employee benefit programs. The Kentucky Department of Insurance scrutinizes captives that write higher-risk lines such as environmental reclamation, medical malpractice, and worker's compensation reinsurance/stop loss.

The Utah Captive Insurance Division should consider implementing a policy stipulating that captives that write certain lines of insurance be subject to full examinations.

When deciding whether or not to conduct an exam, the division should consider what lines of insurance a captive writes, as some are riskier than others.

Significantly, given that the average lifespan of a captive is less than five years, many captives never receive an examination. Also, it appears that when captives convert to a different structure, the five-year exam cycle resets. This means that some captives go longer than five years before they are considered for an exam. The division may want to consider maintaining the original five-year exam cycle instead of resetting.

The Division Needs to Establish a Process Regarding Non-Compliance and Discipline

Non-compliant captives can be penalized by the department. For example, UID can assign penalties and can also revoke the certificate of authority of a captive that is severely out of compliance. However, the captive division pursues disciplinary actions infrequently. Compliance issues often arise when a captive fails to seek prior approval before taking certain actions or when required documentation is not submitted. Captives are required to submit four documents yearly:

- Annual statement of financial condition
- Statement of actuarial opinion
- Annual audit
- Statement of economic benefit

The division needs to establish in policy, the number of and duration of deadline extensions granted to captives.

The captive division frequently grants extensions for submitting these documents without penalizing the captives. However, there is no policy that specifies criteria regarding the length of the extensions and how many will be granted. Without clear policies and procedures, the potential for inequitable treatment increases.

A sponsor captive was out of compliance for almost two years before the division took formal disciplinary action.

A Sponsor Captive Was Out of Compliance for Two Years Before the Division Took Disciplinary Action. A sponsor captive with twenty-eight cells was out of compliance from 2018 through 2020. The captive requested numerous extensions for both the statement of actuarial opinion (which verifies that the captive is solvent) and the annual audit. After granting numerous extensions for submitting the annual audit, the division reached out to the captive's certified public accountant (CPA). This conversation revealed that the captive had been deceitful and had not provided the majority of required documentation for the CPA to perform the audit. Although the captive continuously missed deadlines, the division did not call for an exam or discipline the captive until the reports were nearly two years late. In our review of other captives that have been disciplined, there was variation in the number of infractions that led to discipline (in this case, the revocation of the captive's certificate of authority). This inconsistency with the use of discipline may further the perception of bias. While we do not believe this to be the case, adopting disciplinary policies would help alleviate this possibility.

The non-compliant sponsor captive's parent captive continues to have issues with non-compliance.

Through the market conduct section of UID, the captive in question was assessed a fine and a judge established a new deadline which the captive once again missed. The captive was not referred back to market conduct. Instead, it submitted a plan of orderly withdrawal for the core and its cells three weeks later. At no point during this series of events did the division call for the captive to be examined. Around the same time, the captive's parent captive was also non-compliant and received similar treatment. The parent captive is a pool captive, with multiple participants. As of this writing, the parent captive is still operational and continues to have compliance issues. Despite these issues, in 2021 the division accepted an audit in lieu of an examination.

Captives Often Do Not Meet Capitalization Requirements. Captive insurance companies must keep a specific amount of money in reserves at all times. ***Utah Code*** 31A-37-204 requires captives to keep at least $250,000 to $750,000 (depending on the type of captive) in reserve. Figure 2.2 shows the number and percentage of captives below the minimum requirement over the past four years.

Figure 2.2 About 10 Percent of Captives Do Not Meet Statutorily Mandated Capitalization Levels. It is not clear whether analysts always address this non-compliance.

Year	2018	2019	2020	2021
Total Captives	423	425	410	399
Number Below Capitalization Requirements	41	44	38	41
Percent Below	**10%**	**10**	**9**	10

Source: UID

Figure 2.2 shows that a significant number of captives do not meet the statutory threshold for capitalization. Many of these captives were significantly below the threshold. To remedy this, analysts can work with captives to create a plan to achieve compliance. Due to inconsistent data entry, we were unable to verify the number of times that analysts took formal action with captives that fell below capitalization requirements. However, we found one instance in which the division essentially waived the requirement for a captive. We are concerned about waiving statutory requirements for some but not all captives when the criteria to waive requirements is not in policy. This lack of policies allows some captives to be treated differently and opens the door to favoritism.

Many captives fail to maintain the statutorily prescribed minimum amount of capital.

The Division Should Establish Policies for Other Common Regulatory Actions

Captives are required to obtain permission from the division before undertaking certain kinds of activities. This is partly because some actions could affect the solvency of the captive. Activities that require prior approval include making a loan to a parent company or affiliate, adding or amending lines of insurance, issuing certain dividends, and making investments[6]. While it appears that such requests are evaluated for reasonableness, we believe that there is a need to document criteria, in policy, for when and how these actions are approved. In addition, we believe that additional emphasis should

The division lacks policies regarding captive actions that require prior approval.

[6] Dividends and investments only require prior approval if the action threatens the solvency of the captive. Many captives seek prior approval anyway.

be placed on policies for making a loan to a parent or affiliate company as such loans may carry tax implications.

The division approved a loan after the captive informed the division of its intent to dissolve the captive.

The Division Should Establish Policies Regarding When to Approve Loans to Parent Companies or Affiliates. It is common for captives to issue loans at market interest rates to parent companies or affiliates. Such loans are typically issued when the captive is active and plans to remain active for the foreseeable future. Loans to parent companies have been labeled a transaction of interest by the IRS due to the possibility that a captive could use a loan to transfer money to a parent company while avoiding taxes. Since loans are not viewed by the IRS as income, issuing a loan to the parent company can be a means to move large sums of money back to the parent, tax-free.

Our review found several instances of loans to a parent company or affiliate that were approved, only to have the captive dissolve weeks later. In one instance, a $4 million request was approved after the captive placed a request with the division to dissolve. All the identified loan requests in question were approved by the division. The analysts did not appear to make certain that the loans were paid back before the captives dissolved. The division should ensure that loans are fully paid back to the captive before dissolution is approved.

Recommendations

1. We recommend the Legislature consider whether it is appropriate for the Captive Division to promote the industry given its role as regulator.

2. We recommend that the Captive Division establish policies that include specific criteria which would cause the division to conduct a full scope examination as opposed to accepting an audit-in-lieu.

3. We recommend that the Captive Division conduct full-scope examinations on all complex captives.

4. We recommend that the Captive Insurance Division establish policies that include specific criteria which would cause the division to call a full scope examination when there are concerns about how a captive is operating.

5. We recommend that the Captive Insurance Division establish policies regarding discipline, non-compliance, and the revocation of a captive certificate of authority.

6. We recommend that the Captive Insurance Division establish a formal process for managing captives that fall below the capitalization threshold.

7. We recommend that the Captive Insurance Division establish additional policies outlining how the division approves requests including, but not limited to

    - Issuing loans to a parent company or affiliate
    - Adding or changing a line of insurance
    - Issuing dividends
    - Investments

Chapter III
Captive Insurance Provides the State With Less Economic Benefit Than Originally Estimated

Captive insurance appears not to have a large economic impact on the state of Utah. When it was established in 2003, captive insurance was estimated to bring four to six high-paying jobs per captive to the state. Instead, captive insurance has created less than one job per captive. The Captive Insurance Division and the Legislature could make changes that would yield a modest increase in economic benefit.

The Reported Economic Benefit to the State Is Questionable

Captive insurance has not created the economic benefit originally hoped for. Economic benefit was one of the driving factors when captive insurance was first authorized in 2003. We found that even the modest economic benefit being reported to the division is likely overstated due to incorrect reporting.

Economic Benefit Was a Driving Factor at the Time Captive Insurance Was First Permitted

The Legislature first passed the Captive Insurance Act (Utah Code 31a-37) in 2003. When the bill passed, it was estimated that each captive would likely create four to six high-paying jobs and few lower-level administrative positions. This economic benefit was likely intended to out-weigh losses in premium-tax revenue that comes from businesses purchasing insurance on the commercial market. Insurers pay a 2.25 percent premium tax on traditional policies and 4.25 percent on non-traditional lines[7] of insurance. The state misses out on this tax when captives are formed in lieu of purchasing commercial insurance.

At the time captive insurance was authorized, it was estimated that each captive would create four to six high-paying jobs.

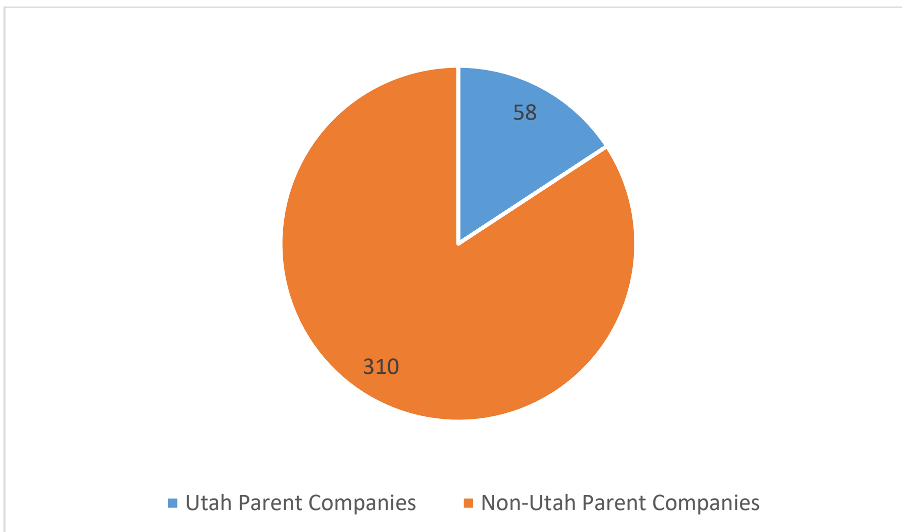
[7] Non-traditional lines are called surplus lines and are not offered by admitted insurers that are licensed and regulated by the division.

The majority of active captives have parent companies located in other states.

Most Parent Companies of Utah-Domiciled Captives Are Not Located in Utah

Utah is currently one of the largest captive domiciles in the United States. The state attracts companies from all over the country to domicile their captives in Utah. As a result, most active captives have parent companies located in other states. Figure 3.1 shows the proportion of captives with Utah parent companies compared with captives that have non-Utah parent companies.

Figure 3.1 Companies Across the United States Domicile Their Captives in Utah. As of 2022, only 58 of Utah's active captives have parent companies located in Utah.



Of the 368 active captives,[8] only 58 (16 percent) were formed by Utah companies. The state with the most captives domiciled in Utah is California, with 101. It is possible that the high proportion of captives with parent companies outside of Utah may contribute to the lower-than-anticipated economic benefit of the captive industry, as discussed in the following sections.

[8] This number is accurate as of April 2022, when the data was pulled.

Captive Insurance Companies Create Less Than One FTE per Company

Utah's median income in 2021 was $67,265 for a single earner. If this number is applied to the expectation that each captive insurance company will create four to six high-paying jobs, Utah should expect to see about $269,000 to $404,000 in economic benefit per captive. Instead, the state has realized an economic benefit of about $25,000 per captive over the past four calendar years. While reported data suggest an average economic benefit of about $43,000 over the same time period, an outlier in the data indicates expenditures that should not have been included in one captive's annual statement of economic benefit.

Captives generate an economic benefit of about $25,000 per captive per year.

In an effort to measure economic benefit, captives are required to submit annual statements of economic benefit. In 2021, the 369 active captives reported a total economic benefit of $18.3 million. However, the captive division does not verify the accuracy of these reports. In our audit process, we identified one company that accounted for $10.2 million (56 percent) of the reported total. Upon further investigation, we determined that about $9.7 million reported by this company as an economic benefit of its captive insurance company should likely not be included. The expenditures in question were normal business expenses associated with the parent company's line of business that would continue to occur in the absence of the captive insurance company. We believe the division could do more to ensure that economic benefit reporting is accurate by providing guidance and by questioning reports that contain outliers.

The division does not verify the accuracy of submitted statements of economic benefit.

Figure 3.2 shows the 2021 adjusted economic benefit ($8.6 million), which is the reported amount ($18.3 million) minus the misidentified expenditures ($9.7 million).

Figure 3.2 Reported Economic Benefit of Captives Is Significantly Lower Than Anticipated. For 2021, we adjusted the total economic benefit by removing $9.7 million in misidentified expenditures.

Year	Adjusted Total Economic Benefit	Number of Captives	Benefit per Captive
2018	$11,201,536	428	$26,172
2019	10,514,832	422	24,917
2020	9,656,732	398	24,263
2021	$8,568,664	369	$23,221

Source: Utah Insurance Department.

Figure 3.2 shows that the economic benefit per captive has decreased over the past four years. Additionally, the benefit per captive is significantly less than the expectation projected when captive was established in the state. Captives also deposit money and invested assets in Utah financial institutions. In 2019, Captives held $1.3 billion in state financial institutions. However, 72 percent of these funds belong to Utah parent companies.

Figure 3.3 shows the 2021 adjusted total economic benefit of $8.6 million (from Figure 3.2) and breaks it down by category.

Figure 3.3 In 2021, Most of the Economic Benefit Consisted of Jobs in the Captive Industry and Fees to UID. The numbers represent 369 captives and may not include some captives that shut down during the calendar year.

Jobs	
Captive Services*	$5,295,757
Annual Fees to UID	1,704,004
Other Expenditures	
Board of Directors Meetings	236,425
Miscellaneous	1,332,478
Total	**$8,568,664**

Source: Utah Insurance Department
**Jobs created by captive excluding UID employees*

Twenty percent of reported economic benefit funds the captive division.

Figure 3.3 shows that the second-highest category is the fee that captives pay to fund the division and its 11 full-time equivalents (FTEs). The fee covers the cost of regulation and some promotional activities, including attending conferences to promote the industry.

This fee accounts for almost 20 percent of the total economic benefit to the state.

Adjustments to Statute and Enforcement May Increase Economic Benefit

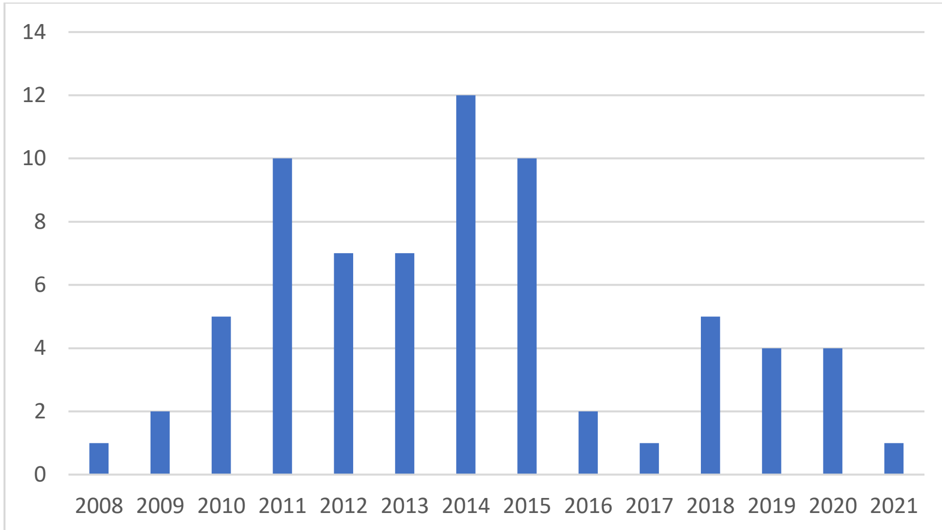
Some changes may be appropriate if the Legislature is concerned about the lower-than-estimated economic benefit of captives. The division could increase some activities and enforcement, which generates economic benefit and continues to fund the division. Such measures would also improve overall regulation. The Legislature could also consider making changes to code. However, it is unlikely that these kinds of changes would generate economic benefit that was originally envisioned for the captive insurance industry.

The Division Should Exercise its Statutory Authority to Conduct Financial Examinations

The Captive Division could increase the economic benefit of Utah captives by conducting full-scope examinations, when appropriate, as discussed in Chapter II. Captives are charged for the cost of the exam. The division is to conduct examinations of individual captives every five years, but it is allowed by statute to waive examinations and instead rely on annual audits conducted by an approved, independent CPA. In practice, the division waives the vast majority of exams, conducting four exams in 2020 and only one in 2021—significantly fewer than in previous years. Figure 3.4 shows the number of full-scope financial examinations conducted each year.

Twenty percent of reported economic benefit fund the captive division.

Figure 3.4 The Number of Annual Full-scope Financial Exams Conducted by the Division Has Decreased in Recent Years. The division reduced the number of full-scope examinations it conducts.



Conducting fewer exams may have partly contributed to the need for a fee increase. While the increase was planned, it was also substantial, increasing by 45 percent. It's possible that a lesser increase could have been adequate if the division generated revenue through examinations of non-compliant and higher-risk captives. However, the decrease in the number of captives, and the resulting decrease in funding was also likely a contributing factor. Furthermore, a new director was appointed in 2016, which may have contributed to a change in philosophy.

The Division Did Not Appear to Enforce the Statutory Requirement to Conduct Annual Directors' Meetings in Utah

Utah Code 31a-37-201 requires captives to "hold at least once each year in the state a meeting of the governing body." In our review of a sample of statements of economic benefit, we identified several captives that did not report spending any money on a directors meeting. While Utah-based parent companies with directors located in the state may have held meetings at little to no cost, we would expect that captives with out-of-state parent companies would have spent money on travel and hotels. During the pandemic, the division did not enforce this requirement. However, the division should consider resuming the enforcement of the statutory requirement for captives to conduct board meetings in the state, unless true hardship is demonstrated by the captive.

The Legislature Could Make Changes to Statute to Increase Economic Benefit

Changes in statute could increase economic benefit from captives. In this section, we discuss the following items the Legislature could consider:

- Requiring captives to hire a captive manager from Utah.
- Charging a self-procurement tax on Utah parent companies that domicile their captive outside of Utah.
- Amending statute to require more than one director to be present to be considered a quorum.

Requirements for Companies to Be Considered Domiciled in Utah Could Be Modified. For example, Vermont (the top domicile in the United States) requires captives to have their principal place of business in the state. This requirement can be met by utilizing a captive manager from the state. In 2018, Vermont reported that its 580 captives spent almost $25 million on captive management alone. Utah's 428 captives (also in 2018) spent less than $6 million. The captive division informed us that at the time the bill passed in 2003, requiring captives to utilize in-state managers would not have worked because there were very few firms located in Utah. Today, there are twenty-three captive management firms in Utah; adding a requirement to utilize a Utah firm may help to further grow the industry.

By requiring the use of in-state captive managers, Vermont enjoys a greater economic benefit from the industry.

A Self-Procurement Tax May Persuade Utah Parent Companies to Establish or Maintain Their Captives in Utah. Both Texas and Tennessee assess a self-procurement tax on parent companies located in their respective states that domicile their captive insurance companies out of state. Kentucky is considering instituting a similar tax. This tax ensures that the state does not lose economic benefit if a parent company chooses to domicile its captive in a state it views as more favorable. The number of Utah parent companies that currently have captives domiciled in other states is unknown.

Current law allows only one director to be in attendance at a board of directors meeting to constitute a quorum.

The Number of Directors Needed in Attendance to Constitute a Quorum Could Be Increased. Utah captives are required to hold an annual board meeting in the state. ***Utah Code*** *31A-37-301(5)(b)* states that "one-third of the members of the governing body of a captive insurance company constitutes a quorum of the governing body." However, captives are only required to have a minimum of three directors meaning that the resident director's presence alone could constitute a quorum. Increasing the number of directors that must be present at a board meeting could result in additional spending in the state. Increasing economic benefit would be especially valuable because captive insurance reduces tax revenue realized by the federal government and the state of Utah.

Recommendations

1. We recommend that the Captive Insurance Division enforce requirements that directly lead to economic benefit, such as requiring in-state board of directors meetings and conducting full-scope financial examinations when appropriate.

2. We recommend that if the Legislature reaffirms that the purpose of captive insurance is economic benefit, it could consider options such as:

    - Requiring captives to hire a captive manager from Utah
    - Implementing a self-procurement tax
    - Amending statute to require that more than one director be present to constitute a quorum

Chapter IV
The Insurance Fraud Division Could Have a Greater Impact on Fraud Prevention

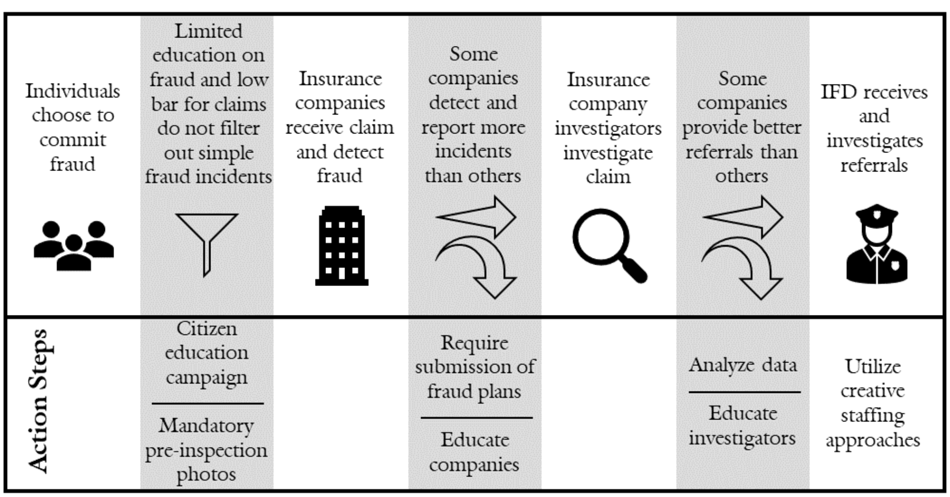
The Insurance Fraud Division (IFD) has statutory authority to provide investigations for all insurance fraud cases in Utah. Compared with its peers, IFD has a higher rate of opening cases, however their current process screens out some important cases. To minimize the number of uninvestigated incidents of fraud, IFD should provide more fraud prevention and education through these steps:

- Require insurers to submit fraud plans
- Provide education to insurers that provide few or poor referrals
- Educate citizens to minimize the rate of fraud

Insurance Fraud Division should provide fraud prevention and education.

Additionally, certain policy options may be considered to decrease the number of low priority fraud cases. We believe IFD operations could be more effective through the education efforts and preventative steps described throughout this chapter. Figure 4.1 shows the process that fraud incidents go through to get to IFD.

Figure 4.1 Several Steps of the Fraud Detection and Investigation Process Screen Out Important Cases. The shaded phases of the chart show gaps where IFD can improve its prevention and education efforts to minimize the screening out of important cases.



The fraud detection and investigation process could be improved through IFD prevention and education.

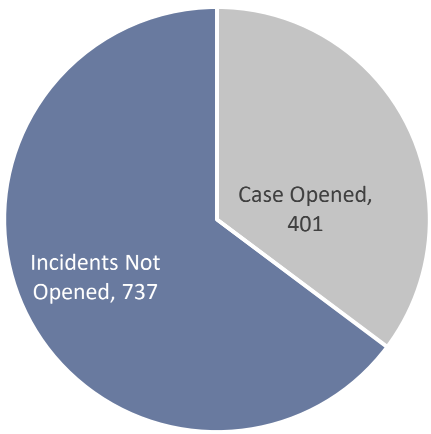
IFD receives more incidents than they can investigate.

During the audit, we sought to understand whether the hundreds of referrals that go uninvestigated are missing major incidents of fraud.

Some Important Incidents of Fraud Go Uninvestigated by IFD

Because IFD is the primary agency that receives referrals for fraud investigation in Utah, they cannot provide full investigations for every instance of fraud reported. Figure 4.2 shows the number of referrals including cases that were opened and uninvestigated incidents.

Figure 4.2 Most Incidents Reported to IFD Go Uninvestigated. While this is common among state fraud units, it suggests that there are possible incidents of fraud that could use more investigation by IFD.



Source: Auditor compilation of 2020 IFD incident data.

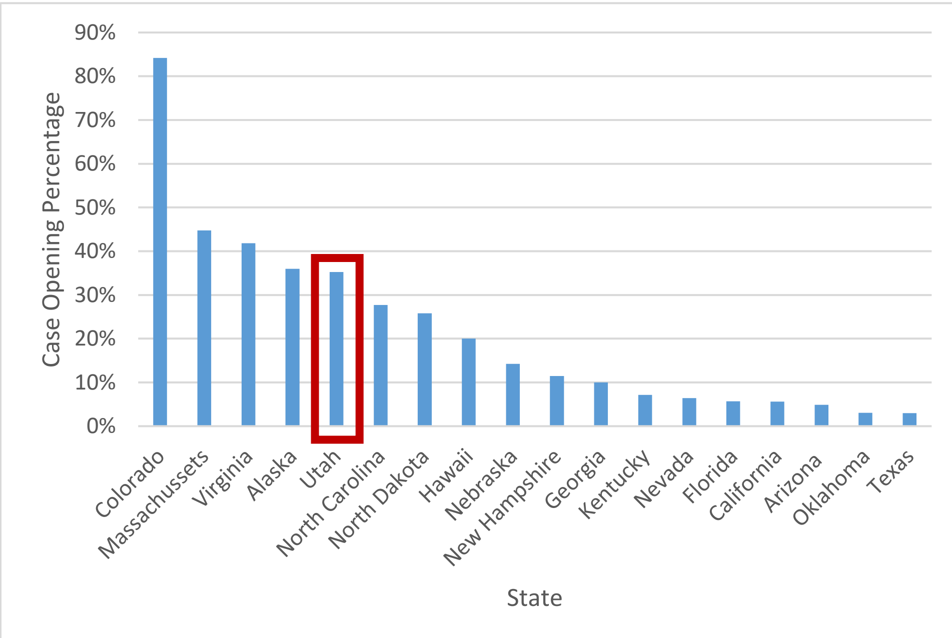
There are many reasons for not investigating referral, such as lack of evidence, poor reporting, lack of jurisdiction, or a lack of investigative resources. While some reasons are out of the control of IFD, if efficiencies could be gained, IFD could investigate a larger percentage of their cases. During the audit, we sought to understand whether the hundreds of referrals that go uninvestigated are missing major incidents of fraud.

IFD has a Higher Case Opening Percentage than Many Fraud Investigation Units in Other States

Figure 4.3, on the next page, shows IFD's case opening percentage in comparison to similar organizations in other states. There remains areas for improvement and prevention which could minimize insurance fraud loss.

Figure 4.3 In 2020, Utah's IFD Performed More Investigations Per Incident Than Did Many Other States[9]. Despite performing better than some other states, IFD still has some areas for improvement to increase the number of investigations they perform.

IFD's case opening percentage shows they perform better than many states.



Source: Incident data received from other states.

We Found Incidents of Credible Fraud Concerns That Went Uninvestigated

5 of 40 incidents we reviewed had significant information that could lead to investigation.

To assess whether there were uninvestigated incidents of fraud that were worthy of investigation, we performed a review IFD uninvestigated incidents. Through our analysis of those forty incidents, including a secondary review with the assistant attorneys general[10] (AAGs), it was determined that five of the forty (12.5 percent) incidents had significant information that could lead to investigation. We believe that 12.5 percent of incidents is substantial enough to warrant a process refinement to ensure more credible fraud cases are investigated.

Uninvestigated incidents can lead to continued patterns of fraud, higher insurance premiums, and a lack of trust from insurance companies.

[9] We attempted to contact every state but received responses from 23 states. Five states responded with no information because they either do not have a special fraud unit or do not have the authority to investigate insurance fraud.

[10] The AAGs we used to review these cases are tasked with prosecuting insurance cases but are not normally consulted in the incident screening process.

Not investigating credible incidents like the five we identified can lead to continued patterns of fraud, higher insurance premiums, and a diminished trust among insurance companies who report it. While the processing of referrals was a major problem noted in the 2009 audit, the current procedures utilize several experts who can determine the merit of cases. This process requires all three of the IFD directors to agree before determining that an incident should be declined. Both the AAGs and the IFD directors have noted that significant incidents at times cannot be investigated due to the division's large caseload. Therefore, as discussed in the rest of the chapter, any efforts to improve the referral process before it comes to IFD could significantly decrease the triage that it currently requires.

Creative Staffing Approaches Could Provide More Time to Deal with Difficult Cases

IFD could use creative staffing approaches to lower costs and provide more time to deal with difficult cases.

IFD uses sworn law enforcement to perform all investigations in the department. While this approach provides greater safety for those involved in in-person interviews and searches, it also creates a higher cost to staff the division with certified officers and buy the necessary equipment. North Dakota has chosen to hire a non-sworn investigator to oversee administrative investigations for lower-level cases, which could lower costs. The ability to use administrative law to deal with insurance fraud cases is already possible under Utah law but is not being utilized. Another approach that could minimize investigation time and costs could be to use another non-sworn staff to do initial follow-up with companies if they provided limited information in their referral. These could be considered as the Utah Insurance Department (UID) and Insurance Fraud Division make staffing decisions moving forward.

IFD Lacks Prevention and Education Activities That Could Increase Its Effectiveness

There are wide differences between companies in their reporting and investigation practices.

Insurance companies play a big role in the fraud investigation process. They are the most likely to recognize and report fraud. Companies also have internal fraud investigations for the purpose of minimizing payouts for fraudulent claims. There are wide differences between companies in their reporting and investigations which change the way that IFD can investigate cases. The Insurance Department has authority to oversee insurance company antifraud plans. However, IFD has never used that authority with leadership citing time limitations as the biggest reason for not requiring companies to submit fraud plans. Despite staffing challenges, we believe the division can't afford not to do this. The ability to substantially increase consistency and strengthen antifraud activities is well worth the time. With better referrals coming in, IFD could have more time to fully investigate resource-intensive cases that go uninvestigated.

IFD Does not Require Insurance Companies to Submit Fraud Plans

State law requires insurance companies to create antifraud plans and provides some requirements for what procedures are included in their plan, including how insurance companies will:

Insurance companies are required to create antifraud plans, but they are not being collected by IFD to assess compliance.

- Detect, investigate, and prevent all instances of insurance fraud
- Educate employees of fraud detection and the antifraud plan
- Provide for fraud investigations through internal fraud investigators or contractors
- Report fraud
- Pursue restitution for financial loss caused by insurance fraud

While the law specifies that the Insurance Department has the authority to collect these plans, IFD does not currently collect them. Statute also gives the Insurance Department authority to require action for noncompliance with the antifraud plan statute. By collecting fraud plans IFD, could identify companies who have poor fraud plans and provide opportunities for the Insurance Department to give guidance to companies on how they can comply with antifraud plan statute. They could also provide best practices based on information provided by the National Association of Insurance Commissioners (NAIC). Ensuring that insurance companies have the correct policies and procedures in place could provide IFD with better referrals. This solution has already been provided through legislative efforts but could be taken greater advantage of. We therefore recommend that IFD require companies to submit their antifraud plans.

Collection of fraud plans would allow IFD to identify companies that could benefit from guidance and best practices.

Insurance companies are required by state law to report suspected fraud.

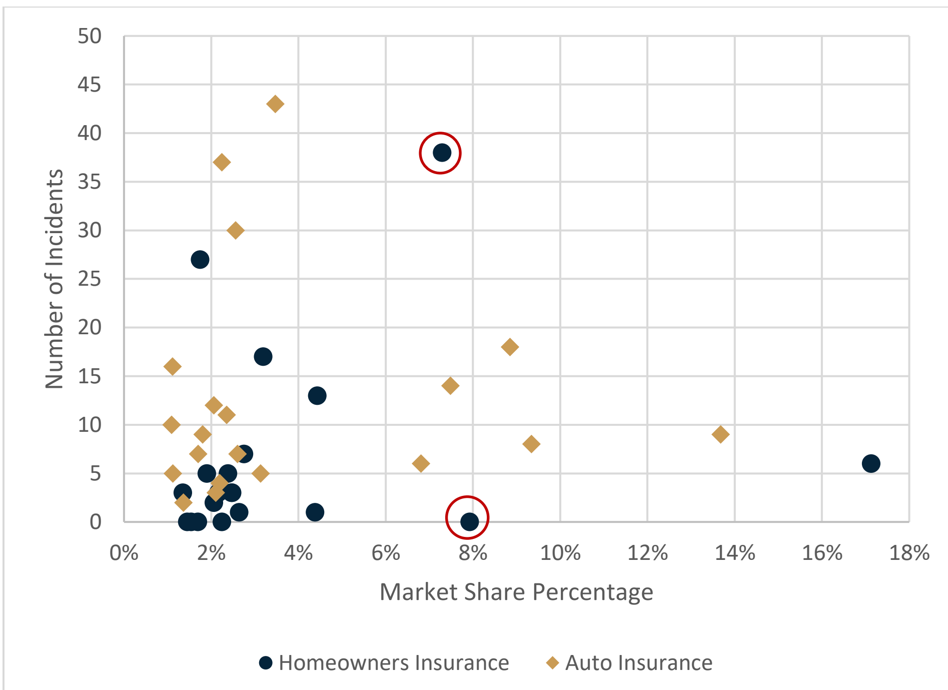
Insurance companies are not providing referrals at similar rates based on their market share.

Without IFD intervention with companies reporting at low rates, the insurance department has no other mechanisms for assessing compliance with fraud statute.

Our Analyses Show That Insurance Companies' Referral Practices Vary

Insurance Companies are required by state law to report suspected fraud. Some companies provide more referrals than others do. Figure 4.4 shows that insurance companies are not reporting fraud at similar rates, based on their market share.

Figure 4.4 Utah's Top Twenty Automobile and Homeowner's Insurers Do Not Report Fraud at a Similar Rate, Based on Their Market Share. There are companies who are likely not reporting all instances of insurance fraud as required by statute. The two companies circled provide an example of companies with similar market share that have wide disparity in their rate of reporting fraud.



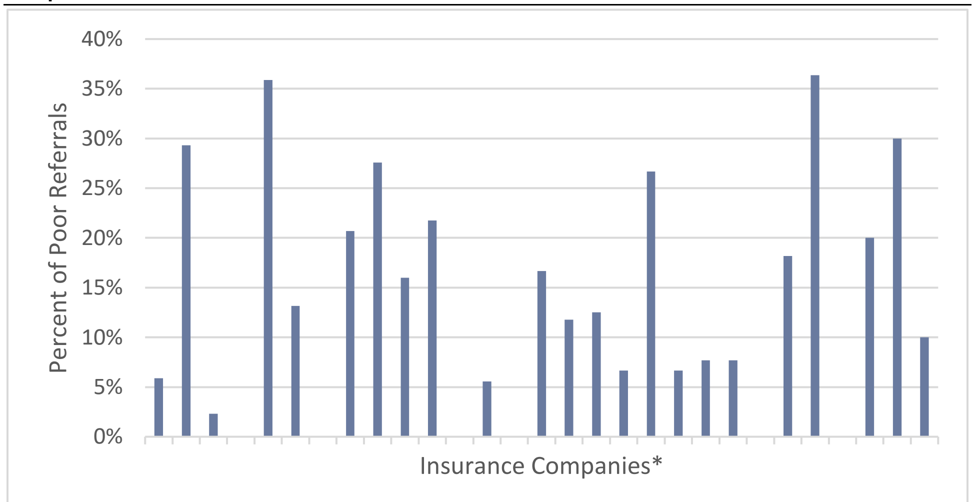
Source: Auditor Compilation of 2020 IFD Incident Data and UID Market Share Report

IFD leadership noted that they have known that companies' fraud reports are not proportionate to their size, but the division has never used its data to evaluate companies for compliance with state law. This disparity in reporting means that some companies are not pursuing fraud, or if companies do have a fraud plan in place, they are not following the mandatory reporting law. Without IFD intervention with these companies, the insurance department has no other mechanisms for checking compliance with fraud statute.

While some insurance companies do not report fraud at the rate that would be expected, there is also a wide range of practices for fraud reporting. IFD leadership reported that some companies provide far better referrals than others. During our incident review, we observed that one of the main reasons it was difficult to determine whether fraud was present was the incomplete narrative written by the insurance company's investigators. Figure 4.5 shows the wide discrepancy between companies in the quality of their referrals.

Some insurance companies provide far better referrals than others.

Figure 4.5 Insurance Companies Have a Wide Range of Practices for Referring Incidents. This figure shows that some companies provide a high percentage of poor referrals, which are unlikely to lead to a criminal investigation. Poor referrals describes incidents where insurance companies did not provide enough information in the initial referral or that they did not respond to requests for further information.



The worst insurance companies provide poor referrals over 35% of the time.

Source: Auditor compilation of 2020 IFD incident data using companies with more than ten referrals.
**Insurance company names have been omitted.*

In 2020, 146 of 737 closed incidents couldn't be investigated because of incomplete referrals or because the company did not provide more files upon request. As shown by Figure 4.5, some companies provide poor referrals over 35 percent of the time. Other companies did not provide any poor referrals. IFD leadership have explained that in many cases, because of the timing of the incident if the insurance company does not provide some level of investigation themselves, all the evidence is gone, and it becomes impossible to prosecute. If insurers were to provide better referrals many cases that are not currently being investigated could be opened for further

If insurers were able to provide better referrals many cases which are not currently being investigated could be opened for further investigation.

investigation. The division could perform analyses such as those provided in this chapter to identify specific companies or investigators are performing the worst. Following those analyses, targeted education and training for companies and investigators from best practices could be performed. We therefore recommend that the Insurance Fraud Division should perform targeted education to companies with poor referral performance.

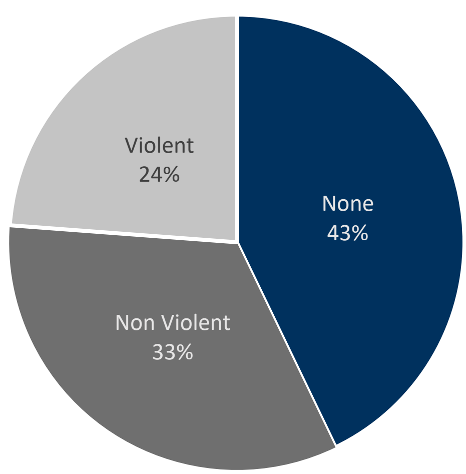
The division could perform analyses such as those provided in this chapter to find specific companies or investigators to target for education.

A More Robust Approach to Citizen Education Could Prevent Crimes

UID has authority to use its funding to provide education to the public on insurance issues. The department has not used that authority in any major way according to UID leadership. Another way that IFD could minimize lower-level offenses in Utah is through citizen education on insurance fraud. IFD reports that many people who are investigated for insurance fraud were unaware that their actions constituted fraud. Among the Utahns whose cases were investigated in 2020, many of them did not have a prior criminal record. Figure 4.6 shows that 43 percent of individuals investigated did not have any prior criminal history.

Many people who are investigated for insurance fraud were unaware their actions constituted fraud.

Figure 4.6 Many Perpetrators of Insurance Fraud Are First Time Offenders. Among the cases where IFD checked criminal history, nearly half had no criminal history. Many of these individuals may not have committed a crime if they were more aware through antifraud education.



Source: Auditor compilation of 2020 IFD incident data

Many individuals with no criminal history may not have committed a crime if they were more aware of fraud severity through antifraud education.

In our research into antifraud marketing, we found that other states such as New Jersey and Pennsylvania have provided robust marketing campaigns against insurance fraud. The agency that oversees insurance fraud in Pennsylvania has collected data to suggest that following their marketing campaign more individuals had knowledge of what insurance fraud was and how serious it was. Having knowledge of the severity of insurance fraud could limit the number of crimes occurring, especially among those committing fraud who do not have a criminal history.

Two states have provided robust marketing campaigns against insurance fraud.

Utah's Division of Consumer Protection Has Provided Similar Marketing Campaigns to Minimize Harm to Citizens. In 2014 and 2015, the Division of Consumer Protection (DCP) ran a series of commercials to educate citizens about the most common scams that get referred to the division. In addition, the division placed several billboards along the highway. DCP modeled its campaign after a similar marketing campaign done by the Division of Securities. DCP spent about $68,000 on the commercials and up to $40,000 on the billboards. It is difficult to measure the effectiveness of billboards, but they may have generated additional referrals from individuals who were unaware of the services offered by the division. As IFD goes forward with this process, we would expect the division will analyze whether the marketing it provides is effective and will make necessary changes based on those data.

Utah's Division of Consumer Protection has also provided education to citizens.

A New Statute to Require Pre-insurance Inspections Could Help Reduce Caseload

A policy consideration for the Legislature is to weigh the pros and cons of requiring inspections of a vehicle be sent into the insurer before the applicant can obtain a policy. This could help deal with some of the most common types of insurance fraud. Five states have done this to prevent "past-posting" incidents. Past-posting is the act of obtaining car insurance after an accident and making a claim stating the accident occurred after insurance was obtained. This type of insurance fraud made up at least[11] 8 percent of the cases that IFD investigated in 2020. If pre-insurance inspections were required, prior

A policy option that could reduce caseload is requiring pre-insurance inspections.

[11] If past posting was not expressly detailed in the narrative, that case was not counted.

visible damage couldn't be claimed later. This could eliminate many of the simple cases IFD has to investigate and create time for investigation of complex cases. We recommend that the Legislature weigh the pros and cons of creating mandatory pre-insurance inspections for automobile insurance providers.

Becoming Certified Law Enforcement Has Led to Higher Liability For IFD

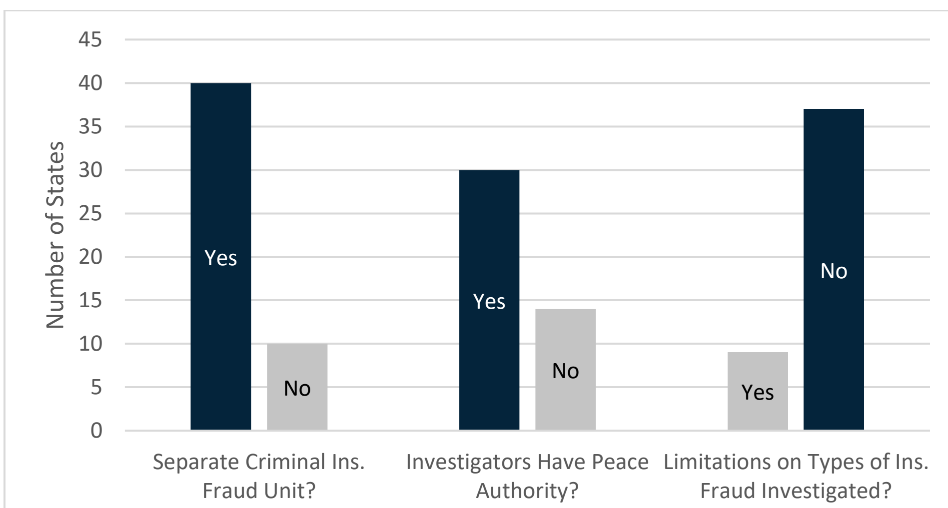
Our 2009 audit recommended that IFD should remain special functions officers.

Our 2009 audit, there was a recommendation that IFD investigators should remain special functions officers (SFOs) rather than becoming fully certified peace officers. The major concerns that our office[12] cited were higher costs of benefits and raised liability.

Since the 2009 audit, Utah, along with most states, has chosen to have sworn insurance fraud units.

In the years since that audit, there have been incidents that led to a national trend to change insurance fraud investigators to be sworn officers. Figure 4.7 shows the current national landscape of insurance fraud investigation.

Figure 4.7 Nationwide, States Have Chosen to Have Sworn Insurance Fraud Units. Among the states with fraud units, most have opted to have sworn officers. Utah remains within the majority (blue bars) of states in how its fraud unit operates.



Source: Auditor compilation of 2020 NAIC data
**Bars in blue show what enforcement Utah and the majority of states have chosen to use for Insurance Fraud.*

[12] Office of the Utah Legislative Auditor General

Because of the issues that have been seen in fraud investigation since 2009 we do not believe the investigators should return to SFO status. However, having certified officers leads to further possible liability for the division. Additions to the policy process that could help mitigate some of this heightened liability.

Having certified officers leads to further possible liability for the division.

A Legal Review of Law Enforcement Policies is a Best Practice That Can Limit Liability

The current process for creating IFD policies is managed by the director and deputy directors. They use a collaborative process to write and evaluate each new policy. Once they have all approved the policy, it is uploaded to the policy manual and is distributed to investigators. While this process does require multiple law enforcement experts to agree, no legal reviews are a part of the policy creation and implementation process.

There is no statutory requirement for IFD to have a legal review of their policies, however it is a law enforcement best practice to limit liability. A publication prepared for the International Association of Chiefs of Police[13] expressed that a legal review of the high-risk policies should be done prior to implementation. Reviews of law enforcement policies can be performed through several different methods such as existing legal counsel, accreditation bodies, or through private companies that provide these services. Each of these options have different costs that should be weighed against the risk that IFD identifies within the division. We recommend that the Insurance Fraud Division perform a legal review of policies to limit liability for law enforcement actions.

IFD should perform a legal review of policies to limit liability for law enforcement actions.

[13] See *Best Practices Guide: Developing a Police Department Policy-Procedure Manual* prepared for the International Association of Chiefs of Police

Recommendations

1. We recommend that the Insurance Fraud Division perform targeted education to companies with poor referral performance.

2. We recommend that the Insurance Fraud Division enforce statute by requiring insurers to submit fraud plans.

3. We recommend that the Insurance Fraud Division provide a more robust insurance fraud education program to educate the public.

4. We recommend that the Legislature weigh the pros and cons of creating mandatory pre-insurance inspections for automobile insurance providers.

5. We recommend that the Insurance Fraud Division perform a legal review of policies to limit liability for law enforcement actions.

Appendix A
Complete List of Audit Recommendations

This report made the following fourteen recommendations. The numbering convention assigned to each recommendation consists of its chapter followed by a period and recommendation number within that chapter.

Recommendation 2.1

We recommend the Legislature consider whether it is appropriate for the Captive Division to promote the industry given its role as regulator.

Recommendation 2.2

We recommend that the Captive Division establish policies that include specific criteria which would cause the division to conduct a full scope examination as opposed to accepting an audit-in-lieu.

Recommendation 2.3

We recommend that the Captive Division conduct full-scope examinations on all complex captives.

Recommendation 2.4

We recommend that the Captive Division establish policies that include specific criteria which would cause the division to call a full scope examination when there are concerns about how a captive is operating.

Recommendation 2.5

We recommend that the Captive Insurance Division establish policies regarding discipline, non-compliance, and the revocation of a captive certificate of authority.

Recommendation 2.6

We recommend that the Captive Insurance Division establish a formal process for managing captives that fall below the capitalization threshold.

Recommendation 2.7

We recommend that the Captive Insurance Division establish additional policies outlining how the division approves requests including, but not limited to

- Issuing loans to a parent company or affiliate

- Adding or changing a line of insurance
- Issuing dividends
- Investments

Recommendation 3.1

We recommend the Captive Insurance Division enforce requirements that directly lead to economic benefit including requiring in-state Board of Directors' meetings and conducting full examinations when appropriate.

Recommendation 3.2

We recommend that if the Legislature reaffirms that the purpose of captive insurance is economic benefit, it could consider options such as:

- Requiring captives to hire a captive manager from Utah
- Implementing a self-procurement tax
- Amending statute to require more than one director present to constitute a quorum

Recommendation 4.1

We recommend that the Insurance Fraud Division perform targeted education to companies with poor referral performance.

Recommendation 4.2

We recommend that the Insurance Fraud Division enforce statute by requiring insurers to submit fraud plans.

Recommendation 4.3

We recommend that the Insurance Fraud Division provide a more robust insurance fraud education program to educate the public.

Recommendation 4.4

We recommend that the Legislature weigh the pros and cons of creating mandatory pre-insurance inspections for automobile insurance providers.

Recommendation 4.5

We recommend that the Insurance Fraud Division perform a legal review of policies to limit liability for law enforcement actions.

Agency Response

State of Utah
SPENCER J. COX
Governor

DEIDRE M. HENDERSON
Lieutenant Governor

Insurance Department

JONATHAN T. PIKE
Insurance Commissioner

September 12, 2022

Kade R. Minchey CIA, CFE
Auditor General
Office of the Legislative Auditor General
P.O Box 145315
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Re: Response to *An In-Depth Budget Review of the Utah Insurance Department (Report 2022-09)*

Dear Mr. Minchey:

Thank you for this opportunity to respond to the recommendations in *An In-Depth Budget Review of the Utah Insurance Department (Report 2022-09).*

The audit was a positive experience for the Department. Over the last several months, we've appreciated working with three professional and collaborative auditors who sought diligently to understand the work we do and who answered our questions as well. Toward the end of the process, we appreciated the respectful, open-minded and clear comments and explanations that you and your staff provided to us in discussing the report. We recognize the value that your office provides and express thanks for its efforts to improve the Department.

We concur with all recommendations in the report. Accompanying this letter is a description of the actions we will take to implement the recommendations and the estimated timelines for completion.

Sincerely,

Jon Pike
Insurance Commissioner

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Utah Insurance Department Response to Legislative Audit 2022
Recommendations, Actions and Timelines

Chapter II – Captive Insurance Division
Improve Division Policies

Recommendation 2.1
We recommend the Legislature consider whether it is appropriate for the Captive Division to promote the industry given its role as regulator.

Department Response: The Department concurs.

Action: If the Legislature requests, the Department will be happy to consult on this recommendation and respond as directed.

Timeline: The Department will participate as requested.

Recommendation 2.2
We recommend that the Captive Insurance Division establish policies that include specific criteria which would cause the division to conduct a full-scope examination as opposed to accepting an audit-in-lieu.

Department Response: The Department concurs.

Action: The Division will, by policy, formalize its current practices for determining the need for a full-scope examination.

Timeline: April 1, 2023

Recommendation 2.3
We recommend that the Captive Division conduct full-scope examinations on all complex captives.

Department Response: The Department concurs.

Action: The Division will adopt and implement a formal policy requiring full-scope examinations on all complex captives.

Timeline: July 1, 2023

Recommendation 2.4
We recommend that the Captive Insurance Division establish policies that include specific criteria which would cause the division to call a full-scope examination when there are concerns about how a captive is operating.

Department Response: The Department concurs.

Action: The Division will, by policy, formalize its current practices for determining the need for a full-scope examination.

Timeline: April 1, 2023

Recommendation 2.5
We recommend that the Captive Insurance Division establish policies regarding discipline, non-compliance, the revocation of a captive certificate of authority.

Department Response: The Department concurs.

Action: The Division will establish these policies in consultation with others in the Department who regularly pursue enforcement actions against licensees.

Timeline: July 1, 2023

Recommendation 2.6
We recommend that the Captive Insurance Division establish a formal process for managing captives that fall below the capitalization threshold.

Department Response: The Department concurs.

Action: The Division will adopt and implement a policy for addressing this issue.

Timeline: January 1, 2023

Recommendation 2.7
We recommend that the Captive Insurance Division establish additional policies outlining how the division approves requests including, but not limited to:

- *Issuing loans to a parent company or affiliate*
- *Adding or changing a line of insurance*
- *Issuing dividends*
- *Investments*

Department Response: The Department concurs.

Action: The Division will, by policy, formalize its current practices for approving these requests.

Timeline: July 1, 2023

Chapter III – Captive Division
Enhance Economic Benefit

Recommendation 3.1
We recommend the Captive Insurance Division enforce requirements that directly lead to economic benefit including requiring in-state Board of Directors' meetings and conducting full examinations when appropriate.

Department Response: The Department concurs.

Action: The Division will, by policy, enforce its requirements for in-state Board of Directors' meetings, and formalize its current practices for determining the need for a full-scope examination (see Recommendation 2.4 above).

Timeline: April 1, 2023

Recommendation 3.2
We recommend that if the Legislature determines that the purpose of captive insurance is economic benefit, it could consider options to increase economic benefit of captive insurance including:

- *Requiring captives to hire a captive manager from Utah*
- *Implementing a self-procurement tax*
- *Amending statute to require more than one director present to constitute a quorum*

Department Response: The Department concurs.

Action: The Department will consult with the Legislature if it decides to consider these proposals and respond as directed.

Timeline: The Department will participate as requested.

Chapter IV – Fraud Division
Greater Efforts to Prevent Fraud

Recommendation 4.1
We recommend that the Insurance Fraud Division perform targeted education to companies with poor referral performance.

Department Response: The Department concurs.

Action: The Division will use its records management system to monitor the quality of referrals and provide feedback. The Division will consider the value of resuming its annual two-day fraud conference that ended due to the pandemic. The Division will, as part of its education program for insurance companies, encourage more insurers to use fraud investigators.

Timeline: January 1, 2024

Recommendation 4.2
We recommend that the Insurance Fraud Division enforce statute by requiring insurers to submit fraud plans.

Department Response: The Department concurs.

Action: The Division is engaged in a nationwide process for insurers to submit fraud plans through a shared electronic portal. Once the portal is in place, the Department will propose legislation that requires fraud plans to be submitted.

Timeline: January 1, 2024

Recommendation 4.3
We recommend that the Insurance Fraud Division provide a more robust insurance fraud education program to educate the public.

Department Response: The Department concurs.

Action: The Division will increase its attendance at community events. The Department will also explore funding for future public awareness campaigns to expand the insurance fraud education program.

Timeline: July 1, 2023

Recommendation 4.4
We recommend that the Legislature weigh the pros and cons of creating mandatory pre-insurance photo inspections for automobile insurance providers.

Department Response: The Department concurs.

Action: The Division will consult with the Legislature as requested and assist with any subsequent legislation.

Timeline: The Department will participate as requested.

Recommendation 4.5
We recommend that the Insurance Fraud Division perform a legal review of policies to limit liability for law enforcement actions.

Department Response: The Department concurs.

Action: The Division will expand its current sources of information in this area by seeking legal advice on its policies from the Attorney General's Office. The Division will evaluate purchasing Lexipol services which provide policy recommendations for law enforcement agencies ($20,000 annually).

Timeline: July 1, 2023