

Senate Banking and Insurance Oversight Subcommittee

Summary Report on the South Carolina Department of Insurance

November 2016

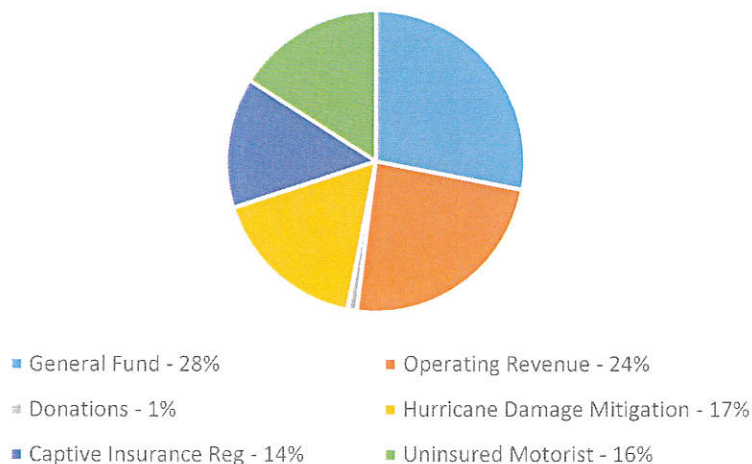


The Department of Insurance's mission is to protect insurance consumers, the public interest, and the insurance marketplace by ensuring the solvency of insurers, enforcing and implementing insurance laws, and regulating the insurance industry. The department is a Cabinet agency that must be reaccredited by the National Association of Insurance Commissioners every five years. The department has a budget of \$13 million and employs ninety-two staff. Through taxes assessed on premiums paid by insureds, the department collects about \$220 million for the state general fund. While the state premium tax is low when compared to other states, the additional premium tax charged by municipalities doubles the amount paid by insurers and has caused insurance companies to move their domiciles to other states. Almost 40% of the department's employees are retired or able to retire within five years, and DOI should continue its efforts in succession planning. For automobile and coastal insurance, the rates paid by South Carolina consumers are competitive when compared with other Southeastern states, although automobile insurers have seen a significant decrease in their profits.

Agency at a Glance

The mission, as stated by the South Carolina Department of Insurance, is to protect insurance consumers, the public interest, and the insurance marketplace by ensuring the solvency of insurers, enforcing and implementing the insurance laws of this State, and regulating the insurance industry in an efficient, courteous, responsive, fair, and equitable manner. The department is a Cabinet agency that is governed by state law and is a member of the National Association of Insurance Commissioners (NAIC). In August 2016, the SC Department of Insurance was reaccredited by the NAIC for five years. The department has revenues of about \$13 million from a variety of sources:

DOI Sources of Revenue FY 15-16



Its expenditures have exceeded its revenues with \$15 million in FY 14-15 and \$14 million in FY 15-16. As of June 30, 2016, the department had eighty-three filled positions out of ninety-four authorized FTEs and nine temporary employees.

Issues

SUCCESSION PLANNING AND RETENTION

As of September 2016, the department had thirty-five of ninety-two (38%) employees who are retired, retirement eligible, or will be retirement eligible within five years. Ten of the twenty-one employees who have separated from the department over the last three fiscal years have retired. Despite having below-average turnover, the department is concerned with retaining employees. The greatest issues it identifies in finding and keeping employees are low salaries and specialized skills.

- **Agency Recommendation: The Department of Insurance should continue its efforts to ensure adequate succession planning and a decreased reliance on temporary employees.**

PREMIUM TAXES

Premium taxes are charged by states on both domestic and foreign insurance companies instead of corporate income taxes. The department collects these taxes and then transfers most of the total collected to the State's general fund. The premium tax and other fees collected by the department generate about \$220 million for the general fund. Currently, the Forestry Commission and the Department of Labor, Licensing, and Regulation get specified percentages of the collections. In addition to the state premium tax, municipalities in the State can also collect a premium tax from insurance companies. For 2015, the Municipal Association of South Carolina collected \$150 million in municipal premium taxes from insurance companies.

South Carolina has a low state premium tax when compared to other states. Only eight states have a lower state tax rate on either life insurance or accident and health insurance. Retaliatory taxes are charged to South Carolina's domestic insurance companies by other states where those companies do business when those states' domestic insurance companies pay fees or taxes in South Carolina that are higher than the ones charged in the home state. Even though South Carolina has a low state premium tax, municipal taxes are included in the calculation of retaliatory taxes by other states. As a result, South Carolina insurance companies pay retaliatory taxes in other states. Over the last several years, the department knows of three companies that have re-domesticated to other states and believes that retaliatory taxes were part of the reason for the re-domestication. Currently, two additional companies are in the process of re-domesticating to the state of Nebraska solely due to the retaliatory tax burden caused by the municipal premium tax.

- **Legislative Recommendation: The General Assembly should review the premium tax structure to evaluate ways to lessen the retaliatory taxes imposed on South Carolina insurance companies by other states.**

AUTOMOBILE AND COASTAL INSURANCE RATES

For automobile and coastal insurance, the rates paid by South Carolina consumers are competitive when compared with the other Southeastern states, although automobile insurers have seen a significant decrease in their profits. According to two different studies, the rates paid by South Carolina drivers are around the median of the rates in the Southeastern states and the nation. However, the profit that automobile insurers earn from South Carolina policies has significantly decreased over the past five years.

The coastal property insurance market seems to be stable, with coverage available in the private market and the total number of policies issued by the Wind Pool decreasing. According to the department's Coastal Market Update for 2016, among the seven Southeastern states with coastal property, only Georgia and North Carolina have a lower average cost per \$1,000 of homeowners' coverage than South Carolina at \$5.07. Only Florida and Louisiana have a larger percentage of insured property value in coastal counties than South Carolina at 28%.

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Report on the Department of Insurance

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Members of Subcommittee:

Senator Ronnie Cromer, Chair
Senator Joel Lourie
Senator Tom Davis

The Department of Insurance's mission is to protect insurance consumers, the public interest, and the insurance marketplace by ensuring the solvency of insurers, enforcing and implementing insurance laws, and regulating the insurance industry. The department is a Cabinet agency that must be reaccredited by the National Association of Insurance Commissioners every five years. The department has a budget of \$13 million and employs ninety-two staff. Through taxes assessed on premiums paid by insureds, the department collects about \$220 million for the state general fund. While the state premium tax is low when compared to other states, the additional premium tax charged by municipalities doubles the amount paid by insurers and has caused insurance companies to move their domiciles to other states. Almost 40% of the department's employees are retired or able to retire within five years, and DOI should continue its efforts in succession planning. For automobile and coastal insurance, the rates paid by South Carolina consumers are competitive when compared with other Southeastern states, although automobile insurers have seen a significant decrease in their profits.

I. Agency at a Glance

Mission

The mission, as stated by the South Carolina Department of Insurance, is to protect insurance consumers, the public interest, and the insurance marketplace by ensuring the solvency of insurers, enforcing and implementing the insurance laws of this State, and regulating the insurance industry in an efficient, courteous, responsive, fair, and equitable manner.

Governing Authority

The department was established in 1908. In 1995, the SC Insurance Commission was eliminated, and the department became a Cabinet agency with a director appointed by the Governor upon the advice and consent of the Senate. As required by state law, the director should be selected based on his training, experience, technical knowledge of the insurance industry, and demonstrated administrative ability.

The department is governed by state law and is a member of the National Association of Insurance Commissioners (NAIC). The NAIC is the US standard-setting and regulatory support organization created and governed by chief insurance regulators from the fifty states, the District of Columbia, and five US territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate regulatory oversight. In August 2016, the SC Department of Insurance was reaccredited by the NAIC for five years.

Operations/Programs

As shown in its organizational chart, the department has divided its operations under four divisions.

Division of Administration and Licensing

The Office of Administration provides administrative support to all areas of the Department of Insurance and is responsible for personnel, procurement, finance, and information resource management.

The Office of Licensing issues operating licenses, approves continuing education courses, and tracks license compliance across the State. It also oversees the appointment of insurance producers by companies hiring them to draft and conduct business on the company's behalf. Those issued licenses by this division include producers,

agencies, brokers, adjusters, public adjusters, appraisers, bondsmen/runners, premium service companies, utilization review companies, rental car agencies, service contract providers, and third party administrators.

Division of Consumer Services and Market Regulation

The Office of Consumer Services assists consumers with insurance complaints. The office helps consumers find coverage and answers questions. Outreach is conducted periodically through publications and presentations across the State. In addition, the office refers complaints to the Legal Office for investigation and possible disciplinary action.

The Office of Market Regulation primarily regulates the business aspects of providing insurance. The office is responsible for monitoring policy forms, rates, and rule filings from insurers providing property and casualty policies as well as life, accident, and health products. The office also assists in promulgating title rates and forms, and collects and analyzes statistical data for trends within the insurance market.

Division of Financial Services

The department uses two different methods to monitor the financial status of insurance companies. Financial Examinations conducts periodic statutory and targeted examinations of South Carolina domestic insurers to assess their financial conditions. These examinations seek to ensure that these companies are able to meet their policyholder obligations through service and the payment of claims. Financial Analysis reviews quarterly financial statements and annual company statements and conducts comprehensive desk audits. The office further reviews financial documents to monitor the financial solvency of insurers participating in the South Carolina domestic insurance marketplace. This office is also responsible for evaluating whether a failing company can be revived or should be liquidated through a court-sanctioned process.

The Captives program area is responsible for bringing captive insurance companies (also known as alternative risk companies) to South Carolina, promoting and regulating their activities. A captive insurance company is generally defined as an insurance company that is wholly owned and controlled by its insureds; its primary purpose is to insure the risks of its owners, and its insureds benefit from the captive insurer's underwriting profits. The office issues new licenses, provides financial surveillance, and monitors market and business conditions in the State.

Division of Legal, Legislative, and External Affairs

The Legal Office represents the department in legal proceedings, drafts legal documents, and advises other divisions on legal issues. It is responsible for investigating alleged violations of the insurance laws by licensees and others. The office also initiates enforcement or administrative disciplinary action against licensees and those entities engaging in the unauthorized transaction of insurance business.

The Office of Legislative Affairs answers inquiries from members and staff of the General Assembly; notifies the General Assembly about the department's initiatives, policies, and programs; and informs other governmental bodies about insurance issues that affect their operations.

The Office of External Affairs coordinates and manages requests from the media and for public education. It is responsible for public outreach and working with members of the media.

Finance

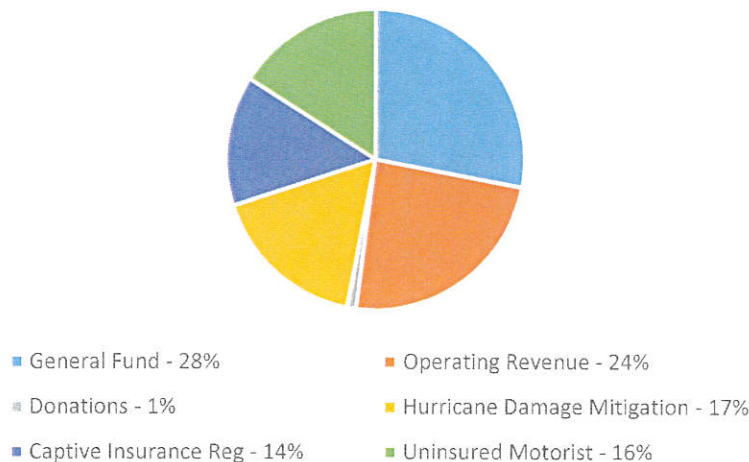
The department has revenues of about \$13 million from a variety of sources, including the general fund and fees collected from the regulation of insurance. Its expenditures have exceeded its revenues with \$15 million in FY 14-15 and \$14 million in FY 15-16.

Fund	FY 14-15		FY 15-16	
	Revenues	Expenditures	Revenues	Expenditures
General Fund	\$3,799,029	\$3,799,029	\$3,838,985	\$3,838,985
Operating Revenue	3,239,170	3,927,909	3,193,637	3,450,050
Donations	77,000	84,724	154,000	76,431
Hurr Damage Mit Prog	2,411,397	3,858,441	2,353,001	2,693,784
Captive Ins Reg	1,704,332	1,713,123	1,895,191	1,893,504
Uninsured Motorist - Admin	189,233	200,000	171,216	200,000
Uninsured Motorist	2,068,000	2,000,021	1,950,826	1,996,674
Federal Funds	0	0	0	46,340
Total	\$13,488,161	\$15,583,247	\$13,556,855	\$14,195,768

Revenues

The department receives revenue from a variety of sources, with the general fund being the largest source of support:

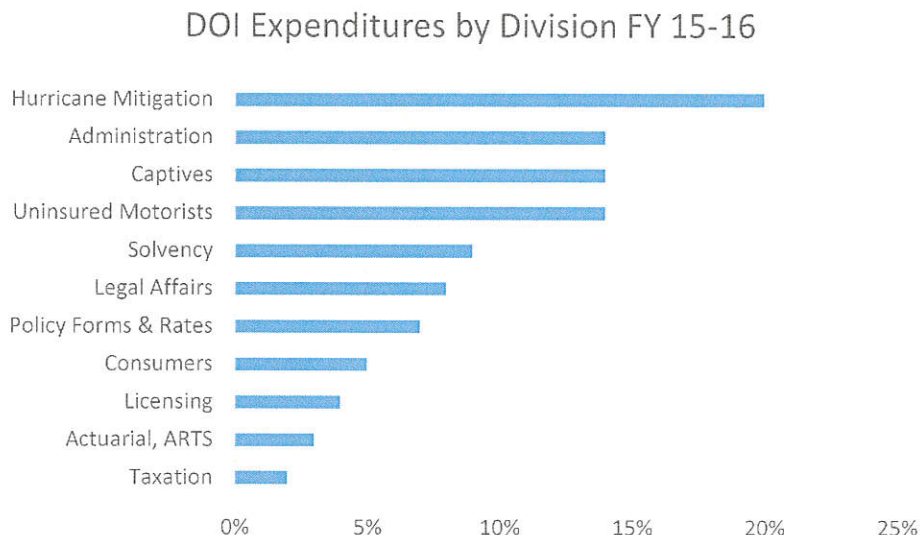
DOI Sources of Revenue FY 15-16



The operating revenues come mostly from the fees that the department keeps for licensing and from related fees. The Hurricane Damage Mitigation revenue comes from an annual transfer of 1% of all premium taxes and 100% of SC Wind and Hail taxes. The donations come from the SC Wind and Hail Underwriting Association. The Hurricane Damage Mitigation funds and donations are used to fund the SC Safe Home program, which provides grants of up to \$5,000 to individual homeowners to retrofit owner-occupied, single-family homes to make them more resistant to hurricane and high-wind damage.

Expenditures

The largest category of expenditures for the department is for the hurricane mitigation program, which awards grants to homeowners funded by premium taxes.



The captives division is mostly self-funded through fees. The uninsured motorist program allocates funds from the uninsured motorist fee to insurance companies to reduce uninsured motorist premiums.

Staffing

As of June 30, 2016, the department has eighty-three filled positions out of ninety-four authorized FTEs and nine temporary employees. The number of filled positions and authorized FTEs has not changed significantly over the last four fiscal years. The number of temporary employees has decreased from a high of twenty-seven in FY 11-12 to a low of nine in FY 15-16.

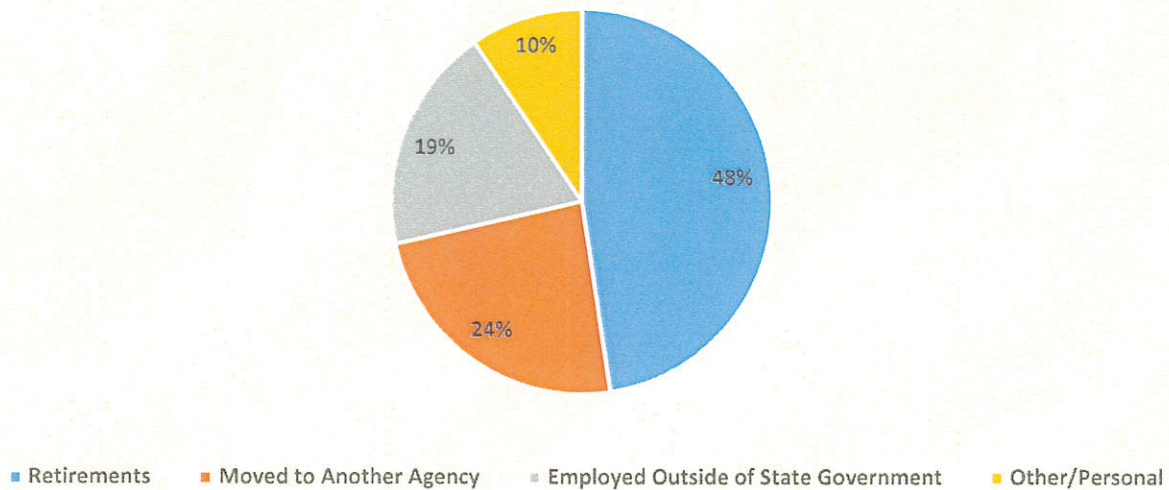
II. Issues

Succession Planning and Retention

Succession Planning

As of September 2016, the department had thirty-five of ninety-two (38%) employees who are retired, retirement eligible, or will be retirement eligible within five years. Ten of the twenty-one employees who have separated from the department over the last three fiscal years have retired. As shown in the chart below, retirement is the reason almost half of the employees leave the agency.

SC DOI Turnover, by Reason (FY 14 through FY 16)



The agency's turnover has been less than 10% over the past three years, which is lower than the average of 16% for state agencies.

Due to concerns about the loss of institutional knowledge and the potential loss of a large number of employees to retirement, the department has developed a succession plan to identify employees who could perform the functions of certain positions and to provide them with necessary cross-training.

Retention

Despite having below-average turnover, the department is concerned with retaining employees. The greatest issues it identifies in finding and keeping employees are low salaries and specialized skills. To address the low salaries, DOI offers raises for changes in job descriptions and achieving certifications or designations. To encourage employees to earn needed certifications and acquire skills needed by the department, DOI will pay for exams and study materials, as well as set aside time for studying. The department has four employees who are studying to become actuaries, positions that are especially needed and difficult to recruit due to the low pay. Despite the certifications and specialized knowledge needed for most of the positions, the department states that it has enough qualified applicants for such positions.

- **Agency Recommendation:** The Department of Insurance should continue its efforts to ensure adequate succession planning and a decreased reliance on temporary employees.

Premium Taxes

Premium taxes are charged by states on both domestic and foreign insurance companies instead of corporate income taxes. The amount of the tax is calculated on the total premiums collected for risks insured in the State. The rates charged on the premiums differs by the type of insurance:

- .75% for life insurance premiums collected
- 1.25% for accident & health, property, casualty, surety, marine, and title insurance premiums collected
- 2.35% for fire department/fire inspection/fire maintenance tax on all fire premiums collected

- 2.5% for workers' compensation premiums collected

The department collects these taxes and then transfers most of the total collected to the State's general fund. Currently, the Forestry Commission and the Department of Labor, Licensing and Regulation get specified percentages of the collections.

State Law	Agency	Amount	Purpose
SC Code §38-7-20(B)	Forestry Commission	2.25% of premium tax	Firefighting and firefighting equipment replacement
SC Code §38-7-30	Division of Fire and Life Safety of the Department of Labor, Licensing and Regulation	1% of fire insurance premiums	Any expenses, including expenses of counsel, detectives, and officers, incurred by the discrimination in rates; 50% must be used for expenses of the Division of Fire and Life Safety
SC Code §38-7-35	Department of Labor, Licensing and Regulation	\$175,000 of 1% of fire insurance premiums	Training, certification, and continuing education program for building codes enforcement officers
Act 60 of 2001 - South Carolina Firefighters Employment and Registration Act	Department of Labor, Licensing and Regulation	.35% of fire insurance premiums	Capital improvements and support at the State Fire Academy, implementation of this Act, regional service delivery of public firefighter education and training, fire prevention services, and public fire safety education, including grants to entities providing fire and life safety education on a statewide basis

Beginning in FY 17-18, the 2.25% of the premium tax that had been sent to the Forestry Commission will be divided as follows:

- 1% to the Forestry Commission for firefighting and firefighting equipment replacement
- 1% to the aid to fire districts account within the State Treasury and distributed for firefighting equipment. One-half of the annual allocated funds must be distributed equally to each fire department in the State, and the remaining balance must be used to fund the V-SAFE program pursuant to Section 23-9-25
- .25% to the aid to emergency medical services regional councils within the Department of Health and Environmental Control for grants to fund emergency medical technician and paramedic training

The transfer of this percentage of the premium tax continues through FY 29-30.

The premium tax and other fees collected by the department from traditional companies generate almost \$200 million.

Fee/Tax	2014	2015
Premium Tax		
Property & Casualty Tax	\$85,709,609	\$90,644,844
Accident & Health Tax	45,382,076	47,584,496
Life Insurance Tax	14,061,606	14,828,393
Workers' Compensation Tax	17,530,487	18,306,696
Fire Department Tax	12,346,702	12,851,330
Fire Inspection Tax	12,346,702	12,851,337
Fire Maintenance Tax	4,321,357	4,497,967
Retaliatory Tax	4,168,162	5,928,581
Biennial Fixed License Fee	0	1,677,020
Biennial License Fee	14,000	1,218,300
Credit Assessment	(13,236,442)	(13,391,042)
Total	\$182,644,259	\$196,997,922

In addition to the taxes and fees collected from traditional companies, the department collects taxes and fees from other regulated entities such as captives and surplus lines. According to the department, after allocating the specified percentages to the entities as described above and collecting the funds from other regulated entities, about \$220 million is deposited in the general fund each fiscal year.

	FY 14-15	FY 15-16
Traditional Companies	\$182,644,259	\$196,997,922
Adjustments for Credits	(1,730,988)	1,117,728
Distributions to LLR	(10,192,432)	(10,669,708)
Distributions to Forestry Comm	(3,058,246)	(3,265,949)
Distributions to Uninsured Employer's Fund	(9,401,140)	(9,223,760)
Other Regulated Entities	65,617,416	45,944,353
Total to General Fund	\$223,878,869	\$220,900,586

According to the SC Revenue and Fiscal Affairs Office, insurance taxes are the fourth highest general fund revenue source, accounting for 2.7% in FY 15-16.

South Carolina has a low state premium tax when compared to other states. Only eight states have a lower state tax rate on either life insurance or accident and health insurance. Retaliatory taxes are charged by this State when SC insurance companies pay fees or taxes in other states that are higher than the ones charged in this State. Insurance companies in those states are charged taxes at a rate equal to what those states charge South Carolina insurers. Other states impose a similar retaliatory tax on SC insurers when their insurers have to pay higher fees and taxes in South Carolina.

Municipalities in this State can impose an additional premium tax on insurers. The state taxes net premiums that are premiums written less any returned premiums or dividends paid or credited to policyholders. The municipalities tax companies on gross premiums written in the State at a property and casualty tax rate of 2% and

a life tax rate of .75%. For 2015, the Municipal Association of South Carolina (MASC) collected for the municipalities \$150 million from insurance companies.

In addition to the premium taxes collected by the MASC, the department collects taxes on insurance brokers for the municipalities, which are sent to the MASC. For the last two years, the department transferred the following brokers' taxes to the MASC:

State FY	2014 Calendar Tax Year	2015 Calendar Tax Year
Fiscal Year 2015	11,260,165	
Fiscal Year 2016	359	12,476,165
Totals	11,260,525	12,476,165

Even though South Carolina has a low state premium tax, municipal taxes are included in the calculation of retaliatory taxes by other states. All state insurance departments impose retaliatory taxes on companies in the same manner. As a result, South Carolina insurance companies pay retaliatory taxes in other states. Over the last several years, the department knows of three companies that have re-domesticated to other states and believes that retaliatory taxes were part of the reason for the re-domestication. Currently, two additional companies are in the process of re-domesticating to the state of Nebraska solely due to the retaliatory tax burden caused by the municipal premium tax.

- **Legislative Recommendation**

The General Assembly should review the premium tax structure to evaluate ways to lessen the retaliatory taxes imposed on South Carolina insurance companies by other states.

Automobile and Coastal Insurance Rates

For automobile and coastal insurance, the rates paid by South Carolina consumers are competitive when compared with the other Southeastern states, although automobile insurers have seen a significant decrease in their profits.

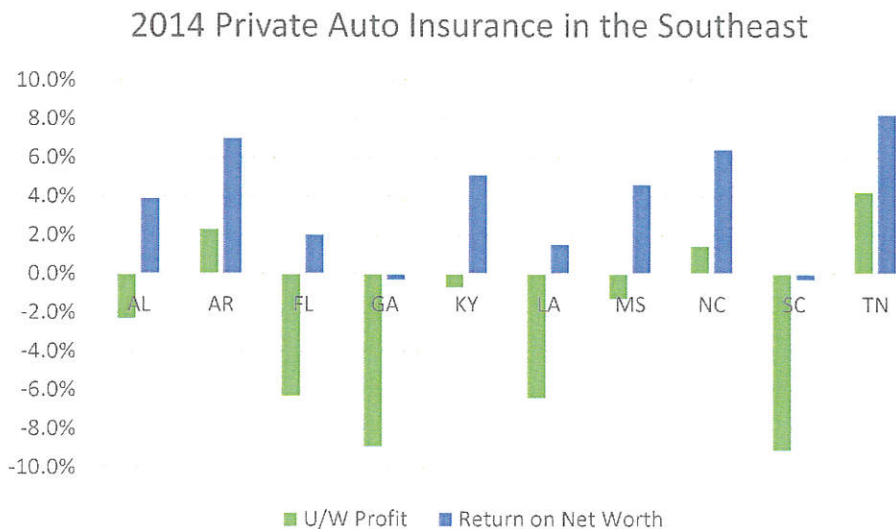
Automobile Insurance

According to two different studies, the rates paid by South Carolina drivers are around the median of the Southeastern states and the nation. In a study based on quotes for a sample risk profile, South Carolina's average premium was sixth among ten Southeastern states and twenty-second in the nation for 2016. South Carolina's premiums increased 2.9% from 2015, a rate lower than the Southeastern (4.9%) and the national (3.5%) average increase.

Another study by the NAIC was based on financial data from insurance companies which was last compiled using 2013 data, and compared average expenditures on auto insurance. South Carolina's average expenditure was fourth among the ten Southeastern states and twentieth in the nation. The State's average expenditure increased 2.9% from 2012, a rate higher than the Southeastern (2.3%) and lower than the national (3.3%) average increase.

The profit that insurers earn from South Carolina policies has significantly decreased over five years. The losses and administrative expenses have exceeded the premiums charged from 2010 to 2014. South Carolina will allow an insurer to allocate 5% of its expenses for profit when developing a rate. For 2014, companies insuring risks in South Carolina saw a -9.1% underwriting profit. Only three of the ten Southeastern states had a positive underwriting profit for that year, but all but two, Georgia and South Carolina, had a positive return on net worth.

The return on net worth is the profit after taxes divided by capital and surplus and is used to measure the profits earned when compared to the net worth in the market.



South Carolina had the lowest combined underwriting profit (-9.1%) and return on net worth (-.3%), with Georgia right behind with -8.9% profit and -.3% return on net worth.

Coastal Insurance

The coastal property insurance market seems to be stable, with coverage available in many instances. Complaints received by the department’s Office of Consumer Services have decreased since the territory of the SC Wind and Hail Underwriting Association (Wind Pool) was expanded in 2007. The department’s Market Assistance Program has also been able to help consumers find savings on their coverage. The property’s location on the coast can also affect rates. Based on the current hurricane models, Hilton Head Island’s losses are about 60% of losses for Charleston and Myrtle Beach.

The market share among the top five property insurers has decreased, which indicates that smaller and non-traditional insurers are providing more coverage. The total number of policies issued by the Wind Pool has been decreasing since its peak in August 2011. The total number of policies has decreased 29%, with total premiums paid declining 25% and the insured limits dropping 33% from August 2011 to December 2015. The five counties in the Wind Pool zone have all had significant decreases in the policies issued by the Wind Pool.

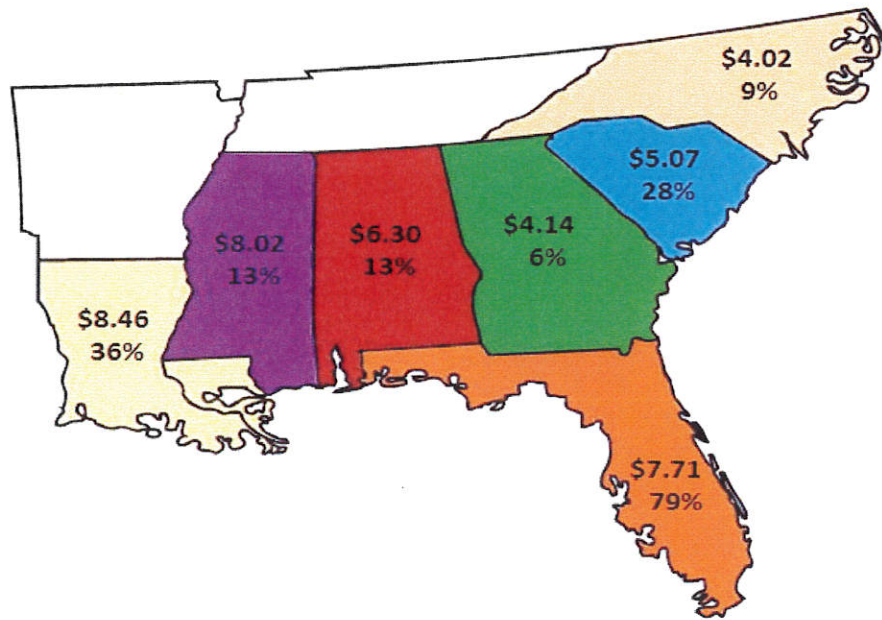
Wind Pool Policies as of December 31, 2015

County	Policies	% of Total	Premiums	% of Total	Insured Limits
Beaufort	7,065	21%	\$17,202,319	24%	\$3,488,496,310
Charleston	7,216	22%	19,210,864	26%	3,074,769,048
Colleton	849	2%	2,168,305	3%	317,253,382
Georgetown	2,940	9%	6,965,279	10%	1,155,132,026
Horry	15,479	46%	27,408,130	37%	3,599,855,494
Total	33,459	100%	\$72,954,897	100%	\$11,635,506,260

Although the number of policies purchased through the Wind Pool has decreased, the number of policies purchased through the private market has also decreased. In September 2015, 110,552 personal line policies were in force, which was a decrease of 4% from the previous year. During that same time period, the commercial policies issued increased by 4.4% to 5,508.

According to the department’s Coastal Market Update for 2016, among the seven Southeastern states with coastal property, only Georgia and North Carolina have a lower average cost per \$1,000 of homeowners’ coverage. Only Florida and Louisiana have a larger percentage of insured property value in coastal counties than South Carolina at 28%.

Southeastern Coastal States: Average Cost per \$1,000 of Coverage and Percent of Insured Property Value in Coastal Counties



Insurance Licensees

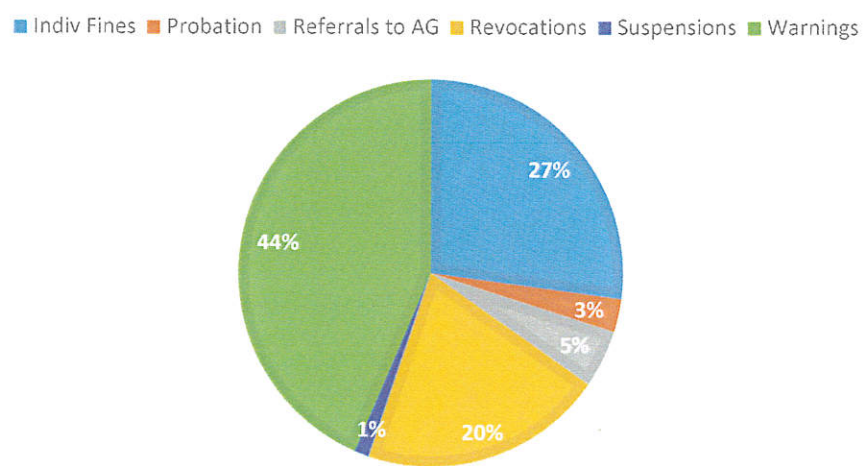
The department is responsible for licensing individuals in several different areas. Over 80% of the licenses are issued to nonresidents.

License	FY 14-15			FY 15-16		
	Resident	Nonresident	Total	Resident	Nonresident	Total
Adjuster	3,221	60,727	63,948	3,072	62,039	65,111
Appraiser	620	1,302	1,922	588	2,460	3,048
Limited Lines	7,974	1,365	9,339	8,094	1,575	9,669
Producer	24,614	120,150	144,764	25,359	128,619	153,978
Professional Bondsman	96	0	96	92	0	92
Public Insurance Adjuster	27	277	304	44	349	393
Special Producer	0	69	69	0	88	88
Surplus Lines Broker	1,800	1,655	3,455	1,646	1,620	3,266
Total	38,352	185,545	223,897	38,895	196,750	235,645

The Office of General Counsel within the department is responsible for investigating complaints and allegations of misconduct against individual licensees. The State Law Enforcement Division and the Attorney General’s Office are responsible for conducting criminal investigations. About 70% of the complaints investigated by the department come through the Office of Individual Licensing, and although producers account for 65% of the licensees, only about 40% of the complaints from this office concern them. These investigations involve appeals of license denials or allegations of violations of insurance or conviction of a crime. About 30% of these complaints concern specialty licensees such as bail bondsmen. This office also receives complaints referred by the Department of Consumer Affairs and the Attorney General’s Office.

Almost 60% of the cases closed over the last three fiscal years resulted in some action taken. The most common disposition was warning letters issued, although 20% of the licensees had their licenses revoked.

ACTIONS TAKEN FY 13-14 THROUGH FY 15-16



The department has noted that investigations of bail bondsmen have been increasing. Even though bail bondsmen constitute fewer than one hundred licensees, they account for 30% of the cases from the Office of Specialty Licensing Services. This may be due to a change in the law requiring surety bondsmen to forward premiums to insurers within thirty days of executing the bond.