

House Bill No. 1010

Presented by: Jon Godfread
Commissioner
North Dakota Insurance Department

Before: Senate Appropriations
Senator Ray Holmberg, Chairman

Date: March 4th, 2021

Good morning Mr. Chairman and members of the Senate Appropriations Committee. For the record, my name is Jon Godfread, Insurance Commissioner. Before we get into the changes we are proposing, I wanted first to give you a very brief summary of our insurance industry here in North Dakota and our Insurance Department.

ND Insurance Industry and Regulation—At a Glance:

The North Dakota Insurance Department is a special funded agency that primarily serves as a consumer protection agency for North Dakota. We receive our funding from the Insurance Regulatory Trust Fund, which is funded by all fees and fines paid for by insurance companies and agents operating in this state.

It is the mission of the North Dakota Insurance Department to protect the public good by fairly and effectively administering the laws of North Dakota. We are committed to vigorous consumer protection efforts, while fostering a strong, competitive marketplace that provides consumers with choices and access to high-quality insurance products and services at competitive prices. In pursuit of our mission, we treat all our constituencies with the highest ethical standards and respect they deserve.

The North Dakota Insurance Department takes pride in helping our citizens by providing effective, resourceful and caring services while inspiring the highest level of consumer trust.

We remain committed to vigorous consumer protection while fostering a strong, competitive marketplace that provides consumers with choice and access to high-quality insurance products and services at competitive prices.

The Department contributed \$60.4 million in premium tax revenue to the state's General Fund last fiscal year. Including turn-back, the Department contributed \$65.6M to the General Fund in 2018. This accounts for more than a \$5.5M increase in General Fund contributions from 2017.

	2016	2017	2018	2019
The insurance industry				
Total premium written	\$5,949,890,632	\$6,026,076,962,	\$6,362,500,575	\$6,416,565,483
Net premium tax collected (General Fund dollars)	\$ 55,571,924	\$55,147,062	\$55,116,891	\$60,410,634
Claims, losses and benefits paid to consumers	\$5,607,737,533	\$5,877,006,129	\$4,558,271,779	\$5,087,412,830
Regulation and consumer protection				
Consumer relief from complaints and hotline contacts	\$2,756,401	\$1,157,967.53	\$500,273	\$2,869,495
Enforcement fines from agents and companies	\$480,054	\$268,501	\$23,800	\$152,770
Benefiting North Dakota taxpayers				
Insurance Regulatory Trust Fund; turn back to the General Fund	\$4,025,635	\$4,300,173	\$4,824,460	\$5,247,806

Department Overview:

The North Dakota Insurance Department began the 2019-2021 biennium with 41 FTEs working in 7 different divisions.

CONSUMER ASSISTANCE DIVISION

The Consumer Assistance Division assists North Dakota consumers having issues or concerns about their insurance by conducting detailed investigations.

STATE HEALTH INSURANCE COUNSELING (SHIC)

Provides free, unbiased and confidential health insurance counseling to Medicare beneficiaries, their families or other representatives. The program held eight Medicare Part D enrollment events in 2019 and moved to a virtual format for the 2020 open enrollment and found that to be very successful.

PRESCRIPTION CONNECTION PROGRAMS

Helps low income North Dakotans find low-cost and no-cost prescription drugs by connecting them with prescription assistance programs offered by various pharmaceutical companies. The program assists consumers with the application process and connects over 95 percent of all applicants to a program.

A mix of state dollars and federal dollars currently funds our Consumer Assistance Division.

PRODUCER LICENSING DIVISION

The Producer Licensing Division is responsible for the licensing of more than 85,000 (5,867 North Dakota resident producers) individual insurance producers doing business with North Dakotans. Insurance producers must comply with pre-licensing exams, background checks and continuing education requirements.

PRODUCT FILING DIVISION

The Product Filing Division reviews policy forms and rate requests to ensure policy language complies with all the laws of this state, properly reflects the benefits provided by the policy and is not deceptive or misleading. For most types of insurance, this division evaluates the premium rates companies propose to charge to ensure that the premiums are not excessive, inadequate or unfairly discriminatory.

EXAMINATIONS AND COMPANY LICENSING

The primary function of the Examinations and Company Licensing Division is to monitor the financial strength of insurance companies licensed to do business in North Dakota.

In 2019, there were 2,331 insurance entities licensed to do business in North Dakota and among them, 29 domiciled companies.

LEGAL DIVISION

The functions of the Legal Division are to provide legal counsel to the Department; investigate insurance fraud and related offenses; investigate and enforce all laws governing insurance producers and insurance companies; litigate administrative actions, and research and prepare proposed legislative bills and administrative rules.

ADMINISTRATION

The Administration Division of the Insurance Department is responsible for oversight of the budget, accounting, IT needs and general office support through the Department. In addition, the division oversees day-to-day business operations, public relations, human resource management and the internal policies and procedures for the Department

Over the past two years we have continued to make some changes to the structure of the Insurance Department. Last session this body approved moving our Boiler Inspection program and Petroleum Tank Storage program to the Department of Environmental Quality as well as moving the administration of the States Fire and Tornado Fund and Bonding Fund to the North Dakota Insurance Reserve Fund.

I am happy to report that both of those moves have been successful, and while we have some minor changes that we will be proposing to the Fire and Tornado Fund (in another bill), that move has truly been one of those rare instances where everyone involved has benefited. Our state has benefited by lowering our administration costs of the program, the clients of the fund have benefited by receiving a more comprehensive overview of their policies and leading to better coverage and our insurance agents are once again at the table, doing what they do best, advising their clients on appropriate coverage levels.

Brennan Quintus from NDIRF has been an excellent partner in making this transition and I wanted to invite Brennan up to give an update from NDIRF perspective on the changes you all approved last session.

- *Brennan Quintus, NDIRF*

We have also done some restructuring of our operations; we have separated out our Fraud Division from our Legal Division. The Fraud Unit was separated from the Legal Division for two important reasons:

1. We recognize that there is a conflict having sworn police officers conduct regulatory investigations. Under the rules of civil procedure, the Department can compel licensees to testify, comply with investigations, and be subject to searches as a condition of their license. However, having a police officer perform these tasks create the possibility of civil rights violations and court challenges, should a case that started as a regulatory investigation evolve into a criminal investigation. Further, it creates confusion and apprehension on the part of the licensee who is facing a regulatory accusation.
2. Under NDCC 26.1-02.1-08 the Fraud Unit was created to conduct independent criminal investigations, we are simply restoring the Fraud Unit to the original function that the Legislature intended.

As of January 1st, 2021, we also combined two divisions and restructured a 3rd. Previously, we had a Consumer Assistance Division that was responsible for assisting consumers with all

business lines of insurance, we also had a Product Filing Division that was responsible for the filing of all business lines of insurance.

Moving forward, we have shifted our focus to the business lines of insurance rather than the functional department operations. Meaning, we now have a Life and Health Division and a Property and Casualty/Producer Licensing Division.

These changes have allowed the experts in each division to be able to focus on the business line versus trying to be everything to everyone. Through making this move we are also able to realize further efficiencies in the removal of one Director position that was previously being filled by Deputy Insurance Commissioner John Arnold.

The last 12 months have certainly caused us to reevaluate much of how we do things at the Insurance Department, the silver lining of the global pandemic is it has forced us to become more efficient, and rethink how we conduct operations. I am pleased to report that in the review of our operations during the pandemic we were not only able to continue to operate at a high level but we can bring these changes forward to sustain those operations all while maintaining a budget reduction.

Last March, most of our staff was instructed to work from home, during the summer months staff were given the option to come back to the office, if they needed to or wanted to. The result of this move has been that roughly 40% of our current staff working in person and 60% working in a telework or hybrid hoteling work model. We have seen a great deal of success with this model and I would argue our productivity has increased by moving to this model.

Much of the work we do at the Insurance Department is of a financial or regulatory nature and we have found removing some of the office distractions has actually made some of our team members more productive, while also allowing us to better utilize our existing space and eliminate one off site location.

By eliminating one of our off-site leases we have saved \$20,986 since August and will be able to realize savings of \$126,000 for the next biennium. We are asking for \$100,000 of those dollars to make modifications to our capitol office space to better accommodate new staff and hotel offices for staff who are in the hybrid working model.

Changes Proposed to 2021-2023 Budget:

In the executive budget recommendation, the Department has already reduced 2 FTEs that are no longer needed. Those FTEs included a Senior Analyst who retired (\$158,485 total salary) and the RAND healthcare review analyst (\$146,880 total salary).

Changes and requests for Insurance Department Budget: The Department previously had a legal assistant position that was being underutilized, and with some restructuring those responsibilities have been successfully transferred to an administrative assistant. Due to the reorganization of our Legal and Fraud Divisions and our emphasis on civil and regulatory activities, we discovered the need for another attorney rather than a legal assistant. As it stands right now, we have one attorney that is responsible for life and health insurance related issues, one attorney who is responsible for property and casualty insurance related issues, one attorney who primarily focuses on criminal investigations related to insurance fraud. We also have a General Counsel who oversees the Legal Division.

At the Insurance Department we also prosecute our own fraud cases. We do this to not only take workload off local states attorneys, but it also allows us to have insurance experts in the court room when prosecuting complex insurance fraud cases. With the restructuring of our Fraud Division we moved one attorney position from the Legal Division to the Fraud Division to focus on fraud prosecution. As I mentioned earlier there are important civil rights reasons that we need to keep that fraud attorney separate from the other Legal Division business.

Given our workload increase we need to hire another full-time attorney and are asking to change our legal assistant position into that fourth full time attorney in our Legal Division. We have continued to strive to improve our communication with the insurance industry. The combination of a shift to more communication with insurance industry representatives and technology

changes that are happening within the insurance industry and the Department, this has created a need for re-incorporating a 4th full time attorney instead of a legal assistant.

- Computer software has replaced many of the responsibilities of a legal assistant, such as elimination of administering paper files for each case, calendaring of hearings and all of the various deadlines for court filings, elimination of court paper filing requirements, email has replaced most written correspondence, etc. All the Legal Division case files are now digital.
- The Legal Division has gradually transitioned from pre-litigation, written formal correspondence, to frequent oral and email communication with insurance industry representatives. We are no longer just sending demand letters, cease and desist orders, and violation notices. We are working out legal issues through conversations with the insurance industry. When speaking with attorneys, insurance industry representatives expect attorneys will be able to answer and provide on demand analysis of legal questions. As a result of these more frequent communications, attorneys are spending more time on research and proactive approaches to regulation.
- The Legal Division has transitioned into research and analysis and away from regulation by enforcement actions. In other words, conversations with the industry representatives have replaced the system of starting a legal action and placing the respondent (company or insurance agency) in the position to defend itself.
- When attorneys routinely communicate and correspond with industry representatives, more situations arise requiring an “ethical communication wall” between the attorneys working in the Legal Division. Attorney’s investigating and communicating with insurance companies are limited because, under the law, the Commissioner is the independent judge and attorneys cannot act as both a witness and the attorney for the Department.
- New technology developments and increased competition in the insurance industry require more legal resources in researching and analyzing new insurance products.
- The development of technology and new insurance products has resulted in new and unique consumer questions regarding insurance policy provisions and coverage.

I know this seems like a touch of overkill on the justification to essentially move one position into other position, but given the result from the House version, I wanted to express just how important this minor change is to the Department.

As I have mentioned, the Department's budget requests to move the legal assistant position to an attorney position at the cost for the biennium of \$221,646, or an increase of \$79,204 from the legal assistant's salary. This is already factored into and supported by the executive recommendation. This change was not included in the House version of 1010. We would ask that the Senate restore the additional funding required to move our legal assistant FTE to an attorney position.

The Department is also requesting to de-classify the supervising examiner position. Doing so will bring the position into an equitable range with peers in other states; and an analysis found that hiring consultants and contractors to do this job would not be fiscally responsible. This was also a recommendation of the National Association of Insurance Commissioners and was discovered during our accreditation process. The Department's request was included in the executive budget recommendation and included in the House version of 1010.

Furthermore, the Department is cutting an additional FTE, which were previously held by the Producer Licensing Division Director due to a reorganization in the Department (\$236,127 total salary and fringe). This was NOT included in the executive recommendation, as we reorganized in January of 2021, but it was adopted in the House version of 1010.

We have also requested funding of \$108,000 for up to 5 temporary employees to assist us during Medicare Part D open enrollment. Open Enrollment is the busiest time for the Insurance Department, certainly for our State Health Insurance Counseling (SHIC) program. Generally, what has happened is we have pulled all of our consumer assistance staff off their normal duties and focused during the 6-week open enrollment time frame solely on Medicare Part D. Even with this shift in duties, we are not able to cover the demand of consumer requests during this time.

We are asking to fund temporary employees so we can hire up to 5 people to work up to forty hours a week for the Department during this time assisting Medicare Part D consumers. This would allow us to not only serve those consumers in a timelier manner, but also allow our

consumer assistance investigators to continue to serve consumers in other lines of insurance. The reality is insurance complaints do not stop during open enrollment, so by providing funding for these temporary employees we can not only serve our consumers better regarding Medicare, but we won't have to pause our regular operations. This request of \$108,000 for temporary staff, for this 6-week period, would fit within the executive budget recommendation but was not included in the House version of 1010. We ask that the Senate incorporate these dollars to our budget.

Operational Line:

As for our operational line, we have assumed that travel will return to normal in the second half of 2021. You do see an increase in the travel line, that is to account for potential uncertainty from the NAIC with regards to their travel arrangement. Under normal circumstances, the NAIC does reimburse the state for much of our travel for NAIC related events, however, given the uncertainty of the past year, we felt it was best to assume, no reimbursement and then be able to turn back those funds if things return to a more normal situation. We have been informed by the NAIC of what travel they will be covering over the next year and what will not be covered. The House version of 1010 removed approximately \$93,000 from our travel line; we are asking that the Senate would restore \$45,000 of that reduction. Our full travel request was approved in the executive recommendation.

Other notable changes on our operating line is a reduction in our rental/lease line to account for the elimination of our North Office lease, and a reduction in professional services.

There are two other outstanding items that may affect our budget that I wanted to make you aware of. The first is we have applied for a grant from the Federal Government, which is the State Flexibility to Stabilize the Market Grant Program, this program is intended to provide added flexibility to strengthen the private health insurance market through implementation of market reforms under Part A of Title XXVII (27) of the Public Health Service Act.

If we are awarded this grant it would be for \$662,000 and start on July 1, 2021. Our notice of award is expected to be on April 1st, 2021. As this was still pending before the House, this sum was not included in our budget. However, we now have more clarity and a preliminary award number, and so ask the Senate to authorize the Department to utilize the expected federal funds of \$662,000 in accordance with the State Flexibility to Stabilize the Market Grant program. This

would primarily consist of an in-depth review of our Essential Health Benefits, a comprehensive review of CHAND, our High-Risk Pool, as well as other market stabilization measures. These dollars would allow us to contract with consultants to potentially tailor solutions that we could then bring to this body next session.

Lastly, in anticipation of the passage of SB 2287, which provides for a comprehensive study of the Coal and fossil fuel industry and the insurance issues related to those industries, we are asking for an additional \$200,000 of special funds so we can complete that study and determine if there is any state action that can be taken to help provide cost-effective insurance to our fossil fuel industry. Senator Bell as the prime sponsor on SB 2287 is here to offer some support and explain her thoughts on this bill. This request was not discussed by the House as SB 2287 had not yet passed in the Senate; it was also not included in the executive recommendation. Without this money, it is not feasible for us to complete the requested study, as contractors will be needed since the Department does not have the expertise to determine viable options for the specialized insurance lines that cover these industries. However, we do believe this study is critically important to determining if there is anything that can be done at the state level to provide any kind of protection or options to this industry.

--Senator Bell--

CONTINUING APPROPRIATION FOR FIRE DISTRICTS:

Funding for Fire Departments and Fire Districts comes from a couple different sources (property taxes, benefits, etc.) but a significant portion of the funding has come from the insurance premium tax. The Department administers the premium tax and from that, the Legislature appropriates an amount up to 100% of the fire insurance premium tax revenue collected.

This is essentially a pass-through fund, whereby we collect the tax and pass that collection on to the fire districts. This fund had a continuing appropriation from 1887 – 1985. Since 1985, funding to the fire districts has fluctuated between 101% of the funds to as low as 48% of the funds available.

We are asking that the continuing appropriation be restored; this ensures that the dollars that are intended to go to the fire districts are actually going to the fire districts. The average consumer likely knows that a portion of their homeowner's insurance premiums goes to funding fire departments. What they do not know is that a portion of those dollars are being put back into the general fund. Our consumers are being double or triple hit, once on their homeowner's insurance premium, once on their property tax, and then again by participating in various benefits put on by Fire Departments to cover their costs.

Last session this body approved an appropriation of \$18,818,030 for distribution to the Fire Districts (\$17,989,505 to the fire departments and \$828,525 to the North Dakota Fire Fighter Association). Actual collections in the fire distribution grant fund are totaling \$20,728,539.83, meaning there is an additional \$1,910,509.83 (90.8% going to Fire Districts 9.2% going to the general fund) going to the general fund that could be utilized by local fire departments.

I want to draw your attention to the audit report that I have also included in our testimony. In 2019, the State Auditor's office conducted an audit of the fire distribution grant fund. The conclusion from the audit was that between the years of 2011-2018 an additional \$13,335,445 was deposited into the general fund, those dollars were collected to fund fire districts across our state and have since gone into the general fund. Ultimately, it was determined by the State Auditor's office that citizens' property insurance premiums could potentially be lowered with increased funding to fire districts, which would allow them to update or improve fire equipment, buildings, and services within their communities. The increased funding approved last biennium is having an impact. From 2019 - 2021 there are 43 fewer class 9 fire departments and 6 fewer class 10 departments. When a fire department moves from a class 9 to class 8 that puts significant downward pressure on premium rates for homeowner's insurance. I encourage you to review the audit report I have included with this testimony, it's essentially 5 pages long and covers in detail why this funding is important, not only for our fire service in our state, but also for the consumers in our state.

I do not expect our Fire Chiefs to be experts in insurance and I know they do not expect me to be an expert in fire service. What I can tell you is we are building a strong partnership that could

lead to more transparent funding for our fire departments, lower premiums and better fire coverage for our consumers.

At this point, I would like to invite the Fire Chiefs up to share some comments.

--Fire Chiefs and Firefighter Association--

It is my belief we can solve this problem with our proposed budget and provide the funding that has been designated and paid by our consumers to the fire service as it has always been intended to be. We would ask that this body consider restoring the continuing appropriation and allow this fund to truly function as a pass-through to the Fire Districts.

CONTINUING APPROPRIATION FOR RAND (APPROVED IN HOUSE BILL 1087):

One last item, just to make the committee aware, a continuing appropriation for our reinsurance program was approved by the house, and was just yesterday approved by the Senate IBL Committee so it will be making its way to this committee, at some point, but that would make the federal funds we get as part of our reinsurance program a continuing appropriation. We can talk more about that when House Bill 1087 is before this committee, but wanted to make you all aware.

Conclusion:

These changes bring the Department's overall budget to \$8,078,903 salary and fringe which is \$340,373 lower than our base executive budget recommendation of \$8,419,276 or a decrease from 19-21 biennium of \$71,096. Our operational changes with all our reorganization changes is a requested appropriation of \$2,514,383. Our total ask for our appropriation comes to \$10,593,285, which includes the \$100,000 onetime capital asset adjustment for the remodeling, the additional \$662,000 in federal grant dollars, an additional \$200,000 for completion of the

fossil fuel insurance study and the continuing appropriation for the Fire District Grand Fund. The Department's FTE count from 19-21 was 41. Our proposed 21-23 FTE count would be 38.

I do feel it's important when considering the Insurance Department budget to look at the last 5 years, as many of you know we have undertaken some significant restructuring and repurposing. Since the 2015-17 biennium and adopting the proposed budget we are bringing forward, the Insurance Department would be down roughly 10% in salary, remaining even in operations and 23% in FTEs. Without the federal grant, or the coal study, and other one-time authorization requests, our department has dropped our operations costs, roughly 40% in the past 5 years, when you look at our day-to-day operations.

We have consistently brought forward budgets over the last 5 years that recognize our need to increase efficiencies which have resulted in greater reductions than targeted by this body.

My ask would be that when considering our request, you take into account the work and reductions we have accomplished over the past 5 years and give us the tools we believe necessary to effectively, resourcefully, and economically uphold the insurance laws of North Dakota.

Happy to answer any questions you might have.

Summarized needs from the Insurance Department:

- Declassification of Legal Assistant Position to an Attorney Position
- Declassification of Supervisory Examiner Position
- \$108,000 for 5 Temporary Employees (Medicare Part D Open Enrollment)
- Restore \$45,000 from the House version for our travel line
- \$662,000 authorization to utilize federal grant money to study/stabilize our individual health insurance market
- \$200,000 for fossil fuel insurance study
- \$100,000 capital asset line for remodel of capitol office for mobile work offices

Reductions:

- Removal of 3 FTEs

Does not include one-time spending or authorization requests:

	2015-17 Expenditures	17-19 to 15-17 Difference	2017-19 Appropriation	17-19 to 19-21 Difference	2019-21 Appropriation	19-21 to 21-23 Difference	2021-2023 Request	21-23 to 15-17 Difference
Salaries	\$ 8,943,097.00	-4.40%	\$ 8,549,567.00	-4.67%	\$ 8,149,998.00	-0.87%	\$ 8,078,902.00	-9.66%
Operating	\$ 2,512,042.00	-13.23%	\$ 2,179,777.00	-28.13%	\$ 1,566,675.00	-0.91%	\$ 1,552,383.00	-38.20%
Total Salary & Operating	\$ 11,455,139.00	-6.34%	\$ 10,729,344.00	-9.44%	\$ 9,716,673.00	-0.88%	\$ 9,631,285.00	-15.92%
FTE	49.50	-7.07%	46.00	-10.87%	41.00	-7.32%	38.00	-23.23%

Including One-time spending of Federal Grant (\$662,000), Coal Study (\$200,000) and Capital Assets (\$100,000):

	2015-17 Expenditures	17-19 to 15-17 Difference	2017-19 Appropriation	17-19 to 19-21 Difference	2019-21 Appropriation	19-21 to 21-23 Difference	2021-2023 Request	21-23 to 15-17 Difference
Salaries	\$ 8,943,097.00	-4.40%	\$ 8,549,567.00	-4.67%	\$ 8,149,998.00	-0.87%	\$ 8,078,902.00	-9.66%
Operating	\$ 2,512,042.00	-13.23%	\$ 2,179,777.00	-28.13%	\$ 1,566,675.00	-0.91%	\$ 2,514,383.00	0.09%
Total Salary & Operating	\$ 11,455,139.00	-6.34%	\$ 10,729,344.00	-9.44%	\$ 9,716,673.00	-0.88%	\$ 10,593,285.00	-7.52%
FTE	49.50	-7.07%	46.00	-10.87%	41.00	-7.32%	38.00	-23.23%

North Dakota Office of the State Auditor

North Dakota Insurance Department

Audit Report for the Biennium Ended June 30, 2019

Client Code 401



North Dakota State Auditor
Joshua C. Gallion



Why We Conducted this Audit

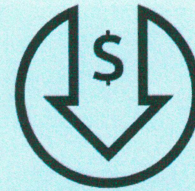
The purpose of this audit was to determine financial transactions including expenditures were made in accordance with law and appropriation requirements.

What We Found

The North Dakota Insurance Department collects insurance premium tax money paid by citizens to insurance companies annually. During our audit, we found that not all the premium money is going back to fire districts, rather some of it is put into the General Fund.

The state legislature limits how much money can be allocated to fire districts each year. Once that cap has been hit, the dollars exceeding the limit are legislatively required to be transferred to the General Fund.

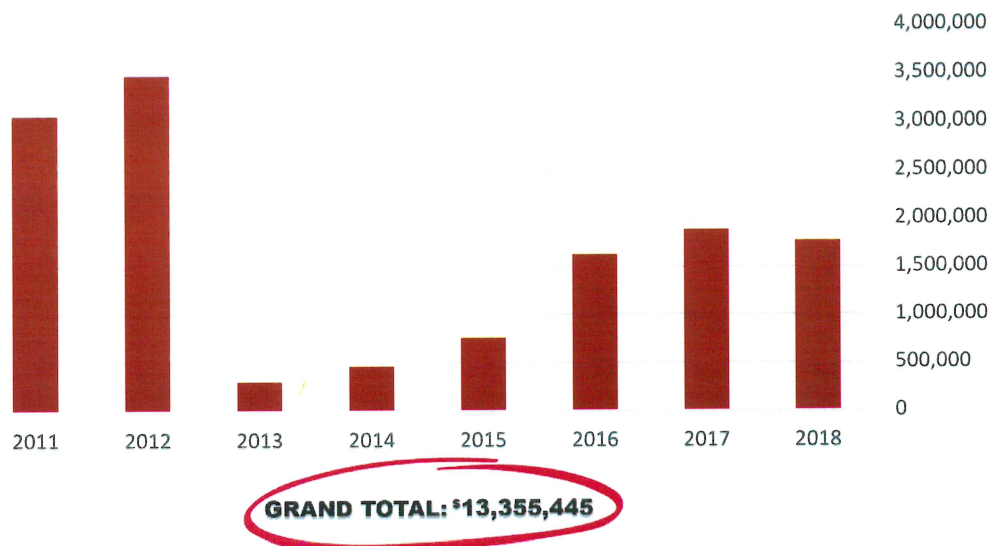
Over 20% of the amount collected was put into the General Fund, totaling \$3,648,941 during the biennium ended June 30, 2019.



Citizen Premiums Could Go Down

Citizens' property insurance premiums could potentially be lowered with increased funding to fire districts for updating or improving fire equipment, buildings, services, etc...in the community.

Fire Insurance Premium Tax Deposited into General Fund - Past 8 Years



KEY PERSONNEL

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Transmittal Letter

August 12, 2019

The Honorable Jon Godfread, Insurance Commissioner

We are pleased to submit this audit of the North Dakota Insurance Department for the biennium ended June 30, 2019. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

The primary consideration in determining the contents of these audits is to produce informative audits to improve government. Statutory audit requirements are an important part of these audits and are addressed by our standard audit objective. Additionally, whenever possible additional audit objectives are included to increase responsiveness and effectiveness of state government.

Robyn Hoffmann, CPA was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 239-7291. We wish to express our appreciation to Commissioner Godfread and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

/S/

Joshua C. Gallion
State Auditor

cc: Legislative Audit and Fiscal Review Committee
Chris Kadrmas, Legislative Council Fiscal Analyst

Audit Results

Distributions to Fire Districts

The audit of the North Dakota Insurance Department (Insurance Department) was designed and conducted to answer the following objective:

- Could additional funds distributed to fire districts for improvements potentially lower citizens' insurance premiums?

Conclusion

Citizens' property insurance premiums could potentially be lowered with increased funding to fire districts for updating or improving fire equipment, buildings, services, etc. in the community.

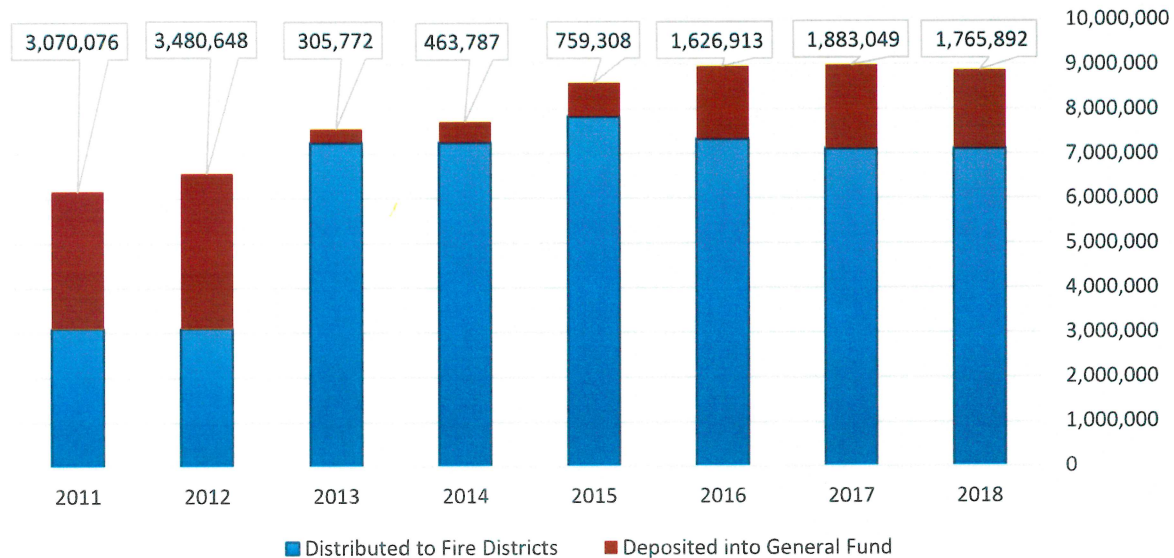
Background Information and Results

The biggest source of revenue for the Insurance Department is insurance premium tax. This is a tax the Insurance Department collects every year on the gross amount of premiums, assessments, and fees that insurance companies received from North Dakota policyholders during the year. Over \$131 million was collected during the 2019 biennium. The types of insurance premiums that are involved include life, accident, health, property, casualty, and surplus lines of insurance. For fire insurance, the tax rate is one and three-fourths percent of the premiums paid which is then submitted to the Insurance Department.

Annually, in December of each year the Insurance Department pays the fire insurance tax money collected back out to certified city fire districts, certified rural fire departments, or certified fire protection districts. This is paid out in the same proportion as the amount of premiums received by insurance companies for fire policies on property within the city, certified rural fire protection district, or area served by the certified rural fire department to the total premiums for those policies in the state. The total amount that can be allocated back out each year is limited to the amount appropriated by the state legislature for this purpose, with the amount exceeding the limit required to be transferred to the General Fund.

We noted over the last eight years the amount collected by the Insurance Department for fire insurance tax always exceeded the amount that was allocated back to the fire districts each year, therefore, there was always fire insurance tax money put into the General Fund rather than going to the fire districts. During the biennium ended June 30, 2019 there was \$3,648,941, or over 20% of the amount collected, that was put into the General Fund. Over the past eight fire insurance premium tax distributions, a total of \$13,355,445, or over 21% of the amount collected, went into the general fund rather than going back to the fire districts where the funds could be utilized to update or improve fire equipment, buildings, services, etc... in the community.

Fire Insurance Premium Tax Distributions



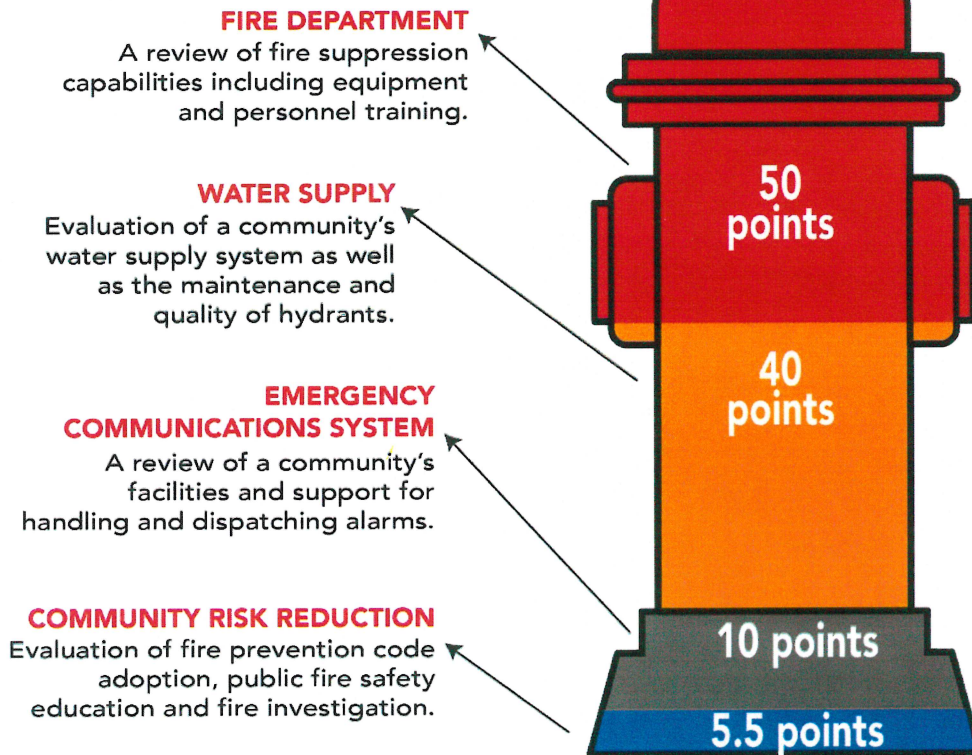
Source: Connect ND

North Dakota taxpayer's property insurance premiums are affected by a rating that is given to communities in the state by Insurance Services Office Mitigation (ISO), a private company.

ISO is an organization that is considered the leading source of information about property/casualty insurance risk. Through a program they have titled Public Protection Classification (PPC) Program, ISO evaluates municipal fire-protection efforts in communities throughout the United States. For ISO's purposes, there can be more than one community included in a North Dakota fire district. ISO performs their evaluations as a service to the insurance industry and does not charge a fee to the communities. The insurers may use ISO information as they see fit in their own business. A community's investment in fire mitigation is a proven and reliable predictor of future losses. Insurance companies use PPC information to help establish fair premiums for fire insurance – generally offering lower premiums in communities with better protection. Many communities use the PPC as a benchmark for measuring the effectiveness of their fire-protection services. The PPC program is also a tool that helps communities plan for, budget, and justify improvements.

ISO collects information on municipal fire-protection efforts in communities throughout the United States. In each of those communities, ISO analyzes the relevant data using their Fire Suppression Rating Schedule (FSRS). The FSRS is a manual containing the criteria ISO uses in reviewing the fire prevention and fire suppression capabilities of individual communities or fire protection areas. There are four major areas that get evaluated. Each area is weighted differently using a point system, with 105.5 being the maximum total points that a community could receive.

CRITERIA USED TO EVALUATE A COMMUNITY'S PUBLIC PROTECTION CLASSIFICATION



Source: ISOMitigation.com

ISO then assigns a PPC rating from 1 to 10. Class 1 generally represents superior property fire protection, and Class 10 indicates that the area's fire-suppression program doesn't meet ISO's minimum criteria.

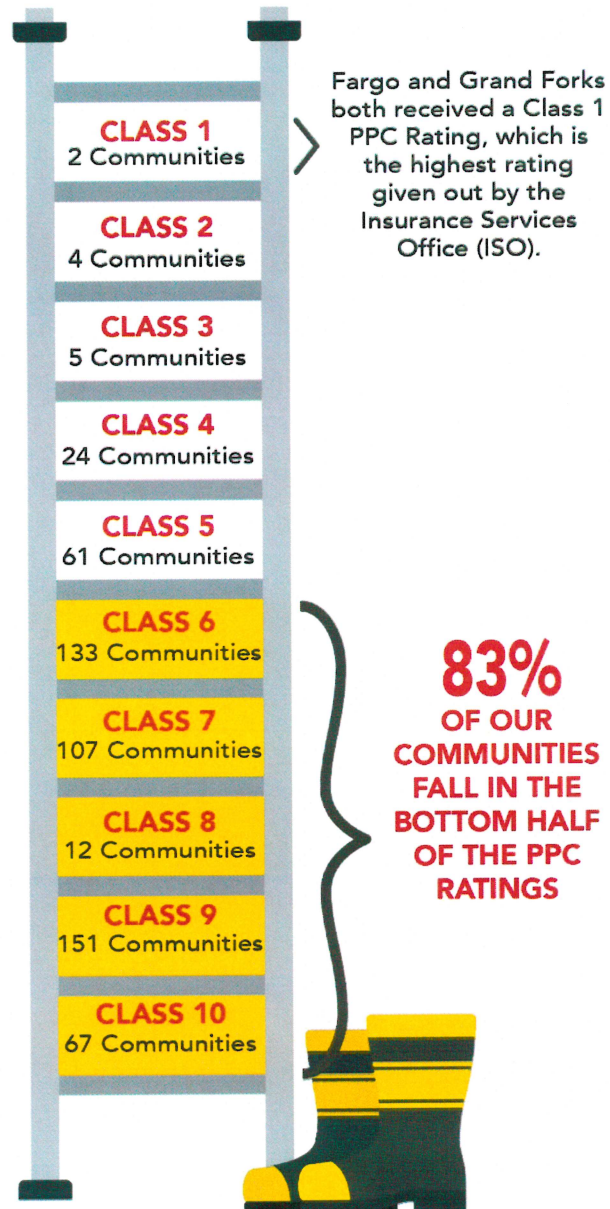
By classifying a community's ability to suppress fires, ISO helps communities evaluate their public fire-protection services. The program provides an objective, countrywide standard that helps fire departments in planning and budgeting for facilities, equipment, and training. And by securing lower fire insurance premiums for communities with better public protection, the PPC program provides incentives and rewards for communities that choose to improve their firefighting services.

According to ISO, most United States insurance companies including the largest ones use PPC information to offer coverages and establish deductibles for individual homes and businesses. Insurance companies, not ISO, establish the premiums they charge to policyholders. They use PPC information to help establish fair premiums for fire insurance – generally offering lower premiums in communities with better protection. Assuming all other factors are equal, the price of property insurance in a community with a good PPC is lower than in a community with a poor PPC. By offering economic benefits for communities that invest in their firefighting services, the program provides an additional incentive for improving and maintaining public fire protection.

The PPC ratings in the state of North Dakota vary from two communities that have the best class 1 rating and 67 communities with the lowest class 10 rating. The highest number of communities have the class 9 rating, as seen in the graph.

Each community's individual PPC rating and report is available to the fire chief or chief administrative official of that community by request directly from ISO.

ND COMMUNITIES BY PPC RATING



Source: ISOMitigation.com; 2017 Annual Report. Retrieved from <https://www.grandforks.gov.com/government/city-departments/fire/annual-report>; City of Fargo website. Retrieved from <http://fargond.gov/city-government/departments/fire/about>.

Internal Control

Our audit did not identify any significant internal controls related to the audit objective.

Scope

Insurance premium tax revenue collections and corresponding distributions to fire districts for years 2011-2018 were reviewed.

The Insurance Department's central office located in the State Capitol was included in the audit scope.

Methodology

To meet this objective, we:

- Interviewed appropriate agency and insurance industry personnel.
- Gathered information from the ISO Mitigation website.
- Inspected documentary evidence.
- Performed an analysis of fire district premiums collected and amounts paid out to fire districts.

In aggregate there were no significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

Statutory Audit Requirements

The objective related to our statutory audit requirements is:

- Are there any exceptions to report relating to statutorily required audit testing?

Statutorily required audit testing includes: performing the post audit of financial transactions, detecting and reporting any defaults, determining that expenditures have been made in accordance with law, appropriation acts, and emergency commission action, and evaluating blanket bond coverage. Defaults are defined as failures to do something required by duty or law. Bonding coverage provides insurance to state agencies for any default or wrongful act on the part of any public employee or public official.

Conclusion

No exceptions to our statutorily required audit testing were identified.

Internal Control

We gained an understanding of internal control and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their

assigned functions, to prevent or detect: misstatements in financial or performance information, violations of laws and regulations or impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we did not identify any deficiencies in internal control that were significant within the context of our audit objectives and based upon the audit work performed.

Scope

This audit of the Insurance Department is for the biennium ended June 30, 2019.

The Insurance Department has operations in the following locations. Each location was included in the audit scope:

- The central office in the State Capitol.
- An offsite location in Bismarck which houses the Consumer Assistance Center and the Special Funds Division.
- An offsite location in Bismarck which houses the Examinations and Company Licensing Division.

Methodology

To meet this objective, we:

- Performed detailed analytical procedures including computer-assisted auditing techniques. These procedures were used to identify high-risk transactions and potential problem areas for additional testing.
- Non-statistical sampling was used and the results were projected to the population. Where applicable, populations were stratified to ensure that particular groups within a population were adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.
- Interviewed appropriate agency personnel.
- Queried the ConnectND (PeopleSoft) system for data analysis. Significant evidence was obtained from ConnectND.
- Observed the Insurance Department's processes and procedures.
- Inspected documentary evidence.
- Tested compliance with appropriation laws and regulations including related transfers. Where necessary, internal control was tested which included selecting representative samples to determine if controls were operating effectively and if laws were being followed consistently.
- Reviewed adequacy of blanket bond coverage by comparing coverage to state bonding guidelines.
- Performed an analysis and selected a sample of high-risk transactions, including administrative expenses, for further testing.

In aggregate, there were no significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

Authority and Standards

This biennial performance audit of the Insurance Department has been conducted by the Office of the State Auditor pursuant to authority within North Dakota Century Code Chapter 54-10.

We conducted this performance audit in accordance with *Generally Accepted Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The criteria used to evaluate internal control is published in the publication *Standards for Internal Control in the Federal Government* issued by the Comptroller General of the United States (Green Book, GAO-14-704G). Agency management must establish and maintain effective internal control in accordance with policy of the Office of Management and Budget (OMB Policy 216).

Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2019</u>	<u>June 30, 2018</u>
<u>Revenues and Other Sources:</u>		
Insurance Premium Tax	\$ 68,567,677	\$ 63,273,934
Licenses and Fees	10,272,939	9,260,899
Fire and Tornado Collections	5,560,797	5,257,714
Revenue from Federal Government	250,951	286,986
Insurance Recoveries	137,958	158,749
Fines and Penalties	46,877	126,402
Other Revenue	2,017	1,231
Bonding Fund Collections	1,270	19,020
Total Revenues and Other Sources	\$ 84,840,486	\$ 78,384,935
<u>Expenditures and Other Uses:</u>		
Grants and Claims	\$ 12,337,757	\$ 9,992,766
Salaries and Benefits	4,040,709	3,965,047
Insurance	3,266,460	3,220,290
Professional Services	545,594	258,536
Rentals and Leases	191,844	181,242
IT Services	170,291	171,515
Travel	115,759	91,631
Operating Fees and Services	86,141	47,124
Supplies	63,376	70,848
Professional Development	30,389	18,780
Equipment	19,465	18,564
Other Expenditures	2,582	1,429
Transfers Out	32,706	79,759
Total Expenditures and Other Uses	\$ 20,903,073	\$ 18,117,531

Source: ConnectND Financials

Statement of Appropriations

For the Biennium Ended June 30, 2019

Expenditures by Line Item:	Final Appropriation	Expenditures	Unexpended Appropriation
Salaries and Wages	\$ 8,549,567	\$ 8,005,756	\$ 543,811
Operating Expenses	2,179,777	1,656,355	523,422
Grants	15,064,086	15,047,562	16,524
Total	<u>\$25,793,430</u>	<u>\$24,709,673</u>	<u>\$1,083,757</u>
Expenditures by Source:			
Other	<u>\$25,793,430</u>	<u>\$24,709,673</u>	<u>\$1,083,757</u>
Total	<u>\$25,793,430</u>	<u>\$24,709,673</u>	<u>\$1,083,757</u>

Source: ConnectND Financials

You may obtain audit reports on the internet at:

www.nd.gov/auditor

or by contacting the Office of the State Auditor at:

Email: ndsao@nd.gov

Phone: (701) 328-2241

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