

**Full Performance Evaluation**

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**Office of Insurance Commissioner**

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**The Insurance Commission Has Important  
Regulatory and Revenue Collection Functions**

**The Insurance Commission Does Not Have  
the Statutory Authority to Conduct Criminal  
Background Investigations on Applicants for  
Insurance Licenses as Recommended By the  
United States Government Accountability Office  
and the National Association of Insurance  
Commissioners**



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February 6, 2005

The Honorable Edwin J. Bowman  
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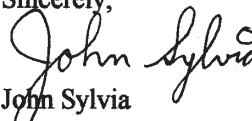
The Honorable J.D. Beane  
House of Delegates  
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1900 Kanawha Boulevard, East  
Charleston, West Virginia 25305-0470

Dear Chairs:

Pursuant to the West Virginia Sunset Law, we are transmitting a Full Performance Evaluation of the *Office of Insurance Commissioner*, which will be presented to the Joint Committee on Government Operations on Sunday, February 6, 2005. The issues covered herein are "The Insurance Commission Has Important Regulatory and Revenue Collection Functions;" and "The Insurance Commission Does Not Have the Statutory Authority to Conduct Criminal Background Investigations on Applicants for Insurance Licenses as Recommended By the United States Government Accountability Office and the National Association of Insurance Commissioners."

We transmitted a draft copy of the report to the Office of Insurance Commissioner on January 20, 2005. We held an exit conference with the Insurance Commissioner on January 26, 2005. We received the agency response on February 1, 2005.

Let me know if you have any questions.

Sincerely,  
  
John Sylvia

JS/wsc

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*Joint Committee on Government and Finance*

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# Executive Summary

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## Issue 1: The Insurance Commission Has Important Regulatory and Revenue Collection Functions.

The Legislative Auditor's staff reviewed the Insurance Commission's data on disciplinary orders during the period from calendar years 1999-2004. Disciplinary orders can result in fines, suspensions, license cancellations, license revocations, hearings or settlements concerning agents and companies. The vast majority of disciplinary orders represent penalty fees imposed on companies for late filing fee or tax payments. The most common offense for which agents are disciplined is misrepresentation. The Legislative Auditor's staff identified a number of specific examples of criminal conduct on the part of licensees.

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*Disciplinary orders can result in fines, suspensions, license cancellations, license revocations, hearings or settlements concerning agents and companies.*

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Data indicated that during the period from CY 1999-2004, three agents were convicted of felonies. Two others committed forgery, whether or not a felony conviction resulted is unknown. One agent failed to disclose that he/she was undergoing a criminal proceeding at the time he/she obtained a license. Felony or forgery convictions are grounds for revoking or canceling licenses, so it is possible that other licensees subsequently experienced criminal convictions in addition to those convictions clearly identified by the Insurance Commission throughout disciplinary process. It is the commissioner's ability to allow an agent to continue working based on the type of felony and the facts of the case.

The Insurance Commission deposited \$95.6 million in the General Revenue Fund during FY 2004. During the same year, the commission collected \$50.7 million for the budgets of various state and local programs. The Insurance Commission collects money from various taxes and fees. The commission collects:

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*According to data supplied to the Performance Evaluation and Research Division, the Insurance Commission distributes the money collected to the General Revenue Fund, Fire Marshall's Fund, Municipal Pensions, Volunteer Fire Department Fund, and the Teachers Retirement Fund.*

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1. 3% premium tax on direct premiums written by insurers. The General Revenue Fund also includes a minimum tax of \$200 per insurer for those insurers with a tax liability of less than \$200 and \$350 from each examination assessment fee paid by insurance companies;
2. 1% premium tax on fire and casualty policies;
3. 1% surcharge on fire and casualty policies
4. Agent exam fees;
5. 0.5% premium tax on fire policies to fund the Fire Marshall's Office;
6. Cash Control Account: Account for fees related to rate and form filings, producer licensing, company renewals, company filings and agent licensing;

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7. Penalty fees;
  8. a 4% premium tax from Surplus Line Licensees.

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*Since the year 1999, the Insurance Commission has distributed an average of \$81,300,502 to the General Revenue Fund.*

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According to a representative of the Insurance Commission, “*The ultimate beneficiary of the funds [collected by the commission] is the General Revenue.*” According to data supplied to the Performance Evaluation and Research Division, the Insurance Commission distributes the money collected to the General Revenue Fund, Fire Marshall’s Fund, Municipal Pensions, Volunteer Fire Department Fund, and the Teachers Retirement Fund. Since the year 1999, the Insurance Commission has distributed an average of \$81,300,502 to the General Revenue Fund. Since fiscal year 1999, the Insurance Commission has deposited an average of 64% of funds collected into the General Revenue Fund while depositing the other remaining 36% into the other funds listed. The commission clearly fulfills an important revenue collection role for the state through its system of insurance taxes, fees and surcharges.

**Issue 2: The Insurance Commission Does Not Have the Statutory Authority to Conduct Criminal Background Investigations on Applicants for Insurance Licenses as Recommended By the United States Government Accountability Office and the National Association of Insurance Commissioners.**

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*Currently the Insurance Commission has no authority to use the West Virginia State Police to assist in criminal background checks of agents who are applying for agent licenses.*

---

Both the Government Accountability Office (GAO, formally called the General Accounting Office) and the National Association of Insurance Commissioners (NAIC) agree that conducting criminal background investigations on applicants for insurance licenses can protect the public from individuals with a history of dishonest behavior. Currently the Insurance Commission has no authority to use the West Virginia State Police to assist in criminal background checks of agents who are applying for agent licenses. The Insurance Commission has background questions on their application but only if the applicant answers “yes” to a previous criminal background will the Legal Division get involved to report if the applicant is eligible for licensure. If a licensed agent had a criminal history but did not indicate this in answers to various background questions on the license application, the commission would attempt to obtain information relating to the applicants conviction. This method of verifying an applicant’s criminal background is contingent on receiving information from an outside source since the commission itself cannot conduct criminal background investigations.



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*The National Association of Insurance Commissioners (NAIC) is currently in the process of developing a Model Law for each state to consider that recommends background checks for insurance agents as well as insurance company officers and directors.*

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The National Association of Insurance Commissioners (NAIC) is currently in the process of developing a Model Law for each state to consider that recommends background checks for insurance agents as well as insurance company officers and directors. The Model Law recommends obtaining fingerprints from each applicant for the purpose of performing a background check through a law enforcement agency. The Criminal Justice Information Services Division of the Federal Bureau of Investigation (FBI) provides criminal history records. The FBI currently charges from \$16 to \$22 per person for conducting criminal background checks. Currently, there are twelve (12) states that have passed legislation utilizing U.S. Public Law 92-544 which authorizes states to submit fingerprints to the FBI and obtain criminal history record information: Alaska, Arizona, California, Colorado, Idaho, Nevada, New Mexico, New York, North Carolina, Pennsylvania, Texas, and Washington.

It is the goal of the NAIC and the GAO to have uniform state regulation in place so that there is no “*rogue migration*” which involves an individual moving to another state and “... *lying on an application and beginning again to engage in unscrupulous activities.*”

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*Since examples of illegal conduct among licensees clearly exist, it is possible that such individuals previously had criminal backgrounds and still obtained licenses in West Virginia, after providing false information on their applications.*

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The Legislative Auditor obtained data from the Insurance Commission on agent disciplinary orders from 1999-2003. There have been documented cases of license revocation due to misappropriation of funds, misrepresentation on applications, felony and forging signatures, (see Issue 1). Since examples of illegal conduct among licensees clearly exist, it is possible that such individuals previously had criminal backgrounds and still obtained licenses in West Virginia, after providing false information on their applications. In the future the Insurance Commission may want to consider background checks for new applicants, and for existing agents upon renewal of the license to further protect the public. Failing to use the State Police or the FBI for the purpose of conducting background checks may permit dishonest agents to practice in this state.

## **Recommendations**

1. *The Legislative Auditor recommends that the Legislature continue the Insurance Commission.*
2. *The Legislative Auditor recommends that the Legislature consider amending the West Virginia Code to enable the Insurance Commission to conduct criminal background checks, through both the Federal Bureau of Investigation and the State Police, on all applicants for new insurance licenses and existing licensees at the time of license renewal.*



# Review Objective, Scope and Methodology

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## Objective

The objective of this report is to determine if the Insurance Commission is active with respect to its basic functions as outlined in Chapter 33 of the West Virginia Code. These functions include taking disciplinary orders against companies and agents, revenue collection, and the screening and licensing of applicants. The screening and licensing of applicants includes a focus on the need for criminal background checks on license applicants as recommended by the National Association of Insurance Commissioners, and the Government Accountability Office.

## Scope

The scope of this review extended from fiscal years 1999-2004 for financial information, non-financial data were organized by calendar year.

## Methodology

The Legislative Auditor's Office obtained information from the West Virginia Insurance Commission in order to document disciplinary orders against agents and companies in the state. Disciplinary data were used to verify that some licensees have been found guilty of criminal activity while working in the state. The commission also provided data on sources and amounts of revenues collected by the commission.

The Insurance Commission provided the Legislative Auditor's Office with the following:

1. Annual reports and financial data for fiscal years 1998-2004;
2. Taxes and fees collected by the Insurance Commission, and the uses of revenues collected by the commission during fiscal years 1999-2004;
3. Disciplinary orders and orders involving agents and companies for calendar years 1999-2004;
4. Data on insurance licensing and screening procedures.

Reports and documents issued by the Government Accountability Office provided information on the need for criminal background checks in the insurance industry. The National Association of Insurance Commissioners' Model Law was reviewed regarding criminal background checks on agents. This audit was conducted in accordance with Generally Accepted Government Auditing Standards.



# Issue 1

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## The Insurance Commission Has Important Regulatory and Revenue Collection Functions.

### Issue Summary

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*Disciplinary orders affecting companies can result in fines, suspensions, license cancellations, license revocations, hearings or settlements concerning agents and companies.*

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The Insurance Commission has important regulatory and revenue collection functions. The Legislative Auditor's staff reviewed the Insurance Commission's data on disciplinary orders during the period from calendar years 1999-2004. Disciplinary orders affecting companies can result in fines, suspensions, license cancellations, license revocations, hearings or settlements concerning agents and companies. Relatively few disciplinary orders result in license cancellation or revocation and the total number of disciplinary actions has decreased considerably since CY 2002. The vast majority of disciplinary orders represent penalty fees imposed on companies for late filing fee or tax payments.

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*The specific examples of criminal conduct available indicate that the commission could further protect the public through the use of criminal background checks, in order to identify undesirable license applicants.*

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A relatively small number of disciplinary orders against agents have taken place each year, however, they most commonly take the form of license revocations or fines, indicating that these are serious offenses. The most common offense for which agents are disciplined is misrepresentation. The Legislative Auditor's staff identified a number of specific examples of criminal conduct on the part of licensees. The specific examples of criminal conduct available indicate that the commission could further protect the public through the use of criminal background checks, in order to identify undesirable license applicants (see Issue 2).

The Insurance Commission deposited \$95.6 million in the General Revenue Fund during FY 2004. During the same year, the commission collected \$50.7 million for the budgets of various state and local programs. The Insurance Commission collects money from various taxes and fees (see Table 3). The commission collects:

1. 3% premium tax on direct premiums written by insurers. The General Revenue Fund also includes a minimum tax of \$200 per insurer for those insurers with a tax liability of less than \$200 and \$350 from each examination assessment fee paid by insurance companies;
2. 1% premium tax on fire and casualty policies;
3. 1% surcharge on fire and casualty policies
4. Agent exam fees;
5. 0.5% premium tax on fire policies to fund the Fire Marshall's Office;
6. Cash Control Account: Account for fees related to rate and form filings, producer licensing, company renewals, company filings and agent

- 
- licensing;
  - 7. Penalty fees;
  - 8. a 4% premium tax from Surplus Line Licensees.

### **The Insurance Commission Actively Regulates Licensed Individuals and Insurance Companies Operating in the State.**

The Legislative Auditor's staff reviewed the Insurance Commission's data on disciplinary orders during the period from calendar years 1999-2004. Table 1 summarizes Insurance Commission orders affecting companies, usually of a disciplinary nature. Disciplinary orders can result in fines, suspensions, license cancellations, license revocations, hearings or settlements concerning agents and companies. According to a commission representative:

*As the data illustrate, relatively few disciplinary orders result in license cancellation or revocation and the total number of disciplinary orders has decreased considerably since CY 2002.*

*Revocations and suspensions involve a hearing [unless an individual agrees to enter a consent order without a formal hearing]. The specific violations determine the fee amount that may be assessed.*

As the data illustrate, relatively few disciplinary orders result in license cancellation or revocation and the total number of disciplinary orders has decreased considerably since CY 2002. The vast majority of disciplinary orders represent penalty fees imposed on companies for late filing fee or tax payments. *West Virginia Code* §33-43-7(a) specifies a fee of \$25 plus interest for any late tax payments.

The decrease in disciplinary orders against companies is the result of a commission policy change whereby late payments from companies no longer automatically result in disciplinary orders. The commission still collects late payment penalty fees, but the process is streamlined. According to the Insurance Commission:

*The change was initiated in 2001 following the passage of the Insurance Tax Procedures Act, West Virginia Code §33-43-1 et. seq. The rationale was a change from a burdensome procedure of entering a consent order or filing an administrative complaint for every late filing penalty. The fees collected were not a material source of revenue. If any fee revenue was lost, it was offset by the reduction in costs of the previous administrative process. Late filing fees and penalties are still collected, however, now the Insurance Commission does not have to go through a formal*

administrative process to collect them. The current process is similar to the process used by the State Tax Department for tax penalties.

<b>Table 1</b>						
<b>Insurance Commission Orders Affecting Companies: CY 1999-2004</b>						
<b>Orders</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
Late Fee: Surcharges	37	67	4	76	2	0
Late Fee: Examination Fees	89	89	4	92	2	0
Late Fee: Premium Taxes	62	105	4	98	5	0
Late Fee: Financial Statements	0	125	0	90	2	0
Liquidation or Acquisition	2	6	4	0	0	0
Orders	21	21	37	62	34	24
Settlements	0	6	9	2	1	0
Revocation of License	3	1	1	4	2	2
Suspended License	3	2	2	2	0	0
Surrender License	2	2	2	0	0	0
Cancel License	1	0	0	0	0	0
<b>Total</b>	<b>220</b>	<b>424</b>	<b>67</b>	<b>426</b>	<b>48</b>	<b>26</b>
<i>Source: West Virginia Insurance Commission. Data for CY 2004 represents the year-to-date as of October 12, 2004.</i>						
<i>*The commission canceled or revoked licenses for entering pleas of guilt on felonies, forgery, untrustworthiness, or as a final order for a contested case.</i>						

Table 2 provides an overview of disciplinary orders taken against individual agents from calendar years 1999-2004. A relatively small number of disciplinary orders have taken place each year, however, they most commonly take the form of license revocations or fines, indicating that these are serious offenses. The most common offense for which agents are disciplined is misrepresentation.

<b>Table 2</b>						
<b>Disciplinary Orders Taken Against Agents: CY 1999-2004</b>						
<b>Orders</b>	<b>1999</b>	<b>2000*</b>	<b>2001*</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
Cancel License*	2	0	0	0	0	0
Revoke License*	8	30	10	13	7	8
Fines	4	10	15	9	9	6
Hearings	1	0	0	0	2	0
Reinstatement of License	1	0	0	0	1	0
Deny Hearing	0	0	0	0	1	0
Deny Rehearing	0	0	1	1	0	0
Deny License Application or Renewal	0	0	0	2	0	1
<b>Total</b>	<b>16</b>	<b>40</b>	<b>26</b>	<b>25</b>	<b>20</b>	<b>15</b>
<p><i>Source: West Virginia Insurance Commission. Data for CY 2004 represents the year-to-date as of October 12, 2004.</i></p> <p><i>* In 2000, there was also one order granting an extension of time and one allegation dismissed. In 2001, there was one enforcement order for failure to pay child support.</i></p> <p><i>*The commission cancels or revokes licenses for entering pleas of guilt on felonies, forgery, untrustworthiness, or as a final order for a contested case.</i></p>						

**Data from the Insurance Commission indicate that some licensees engage in criminal conduct and may have had criminal backgrounds at the time they obtained licenses**

Disciplinary data maintained by the commission are not designed to provide an exact count of the number of criminal convictions regarding licensees. The data indicate actions that the commission judged to be inappropriate, whether or not the offender experienced a criminal conviction as a result. The Legislative Auditor’s staff identified a number of specific examples of criminal conduct on the part of licensees. Data indicated that during the period from CY 1999-2004, three agents were convicted of felonies. Two others committed forgery, whether or not a felony conviction resulted is unknown. One agent failed to disclose that he/she was undergoing a criminal proceeding at the time he/she obtained a license. In 2002, the commission handed down the largest fine for misrepresentation. The agent was fined \$21,000 and had his/her license revoked. Whether or not a fraud



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*In 2003, an agent's license was revoked due to the revocation of a license in another state. Another agent was convicted of "blackmail and similar forms of extortion" which caused his license to be revoked. During 2004, no licenses were revoked for misrepresentation or misappropriation, but instead, for such causes as: civil penalties, failure to report a Class U misdemeanor and two cases of cease and desist transactions which resulted in the highest agent penalties of \$730,000 each.*

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*It is possible that an individual convicted of a felony unrelated to the insurance industry might be able to obtain an insurance license.*

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conviction resulted is unknown. In 2003, an agent's license was revoked due to the revocation of a license in another state. Another agent was convicted of "blackmail and similar forms of extortion" which caused his license to be revoked. During 2004, no licenses were revoked for misrepresentation or misappropriation, but instead, for such causes as: civil penalties, failure to report a Class U misdemeanor and two cases of cease and desist transactions which resulted in the highest agent penalties of \$730,000 each. As Table 1 and 2 indicate, a total of 93 agents/companies had licenses canceled or revoked during the period from CY 1999-2004.

Felony or forgery convictions are grounds for revoking or canceling licenses, so it is possible that other licensees subsequently experienced criminal convictions in addition to those convictions clearly identified by the Insurance Commission throughout disciplinary process. According to *West Virginia Code* § 33-12-24 (b) (6):

*The Insurance commissioner may place on probation, suspend, revoke or refuse to issue or renew an insurance producer's license, solicitor's license or excess broker's license, or may levy a civil penalty or any combination of actions, for any one or more of the following causes: (6) Having been convicted of or pleaded nolo contendere to any felony.*

It is possible that an individual convicted of a felony unrelated to the insurance industry might be able to obtain an insurance license. According to an Insurance Commission representative:

*A felony conviction results in a review of the application [to obtain an insurance license] whereby if it is not an 18 USC 1033 felony, a decision is made upon the individual facts of the conviction.*

The specific examples of known criminal conduct by licensees indicate that the commission could further protect the public through the use of criminal background checks, in order to identify undesirable license applicants (see Issue 2).

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## **Sources of Revenues Collected By the Insurance Commission**

According to a representative of the Insurance Commission, “*The ultimate beneficiary of the funds [collected by the commission] is the General Revenue.*” This does not apply to funds earmarked for certain uses such as the Fire Marshall’s Fund, Municipal Pensions, Volunteer Fire Department Fund, and the Teachers Retirement Fund. Since the year 1999, the Insurance Commission has distributed an average of \$81,300,502 to the General Revenue Fund. According to the Insurance Commission’s estimates for FY 2005, it will collect up to \$143,000,000 in taxes and penalties and \$7,400,000 in fees obtained from tests and license renewals.

**Table 3**  
**Insurance Commission's Taxes and Fees Collected: FY 1999-2004**

Year	1999	2000	2001	2002	2003	2004
<b>GRF: 3% Premium Tax, &amp; 1% Annuity Tax</b>	\$62,803,944	\$70,887,607	\$76,614,666	\$86,095,683	\$91,998,144	\$94,634,762
<b>1% Premium Tax on Fire &amp; Casualty Policies</b>	\$14,512,591	\$14,741,472	\$15,438,273	\$18,295,997	\$22,477,831	\$24,077,758
<b>1% Surcharge on Fire &amp; Casualty Policies</b>	\$13,896,380	\$14,092,924	\$14,706,826	\$16,187,082	\$20,039,320	\$19,768,759
<b>*Exam Fees-1</b>	\$459,550	\$478,879	\$806,050	\$493,850	\$615,148	\$489,689
<b>GRF: *Exam Fees-2</b>	\$917,750	\$957,258	\$1,612,580	\$886,950	\$3,597,647	(\$1,674,109)
<b>0.5% of Fire Insurance Policies</b>	\$829,540	\$862,348	\$877,499	\$1,001,445	\$1,294,227	\$1,163,756
<b>Cash Control Account</b>	\$4,124,172	\$4,522,827	\$4,911,695	\$5,054,608	\$4,781,328	\$7,414,101
<b>GRF: Penalty Fees</b>	\$150,921	\$101,501	\$85,798	\$420,680	\$174,851	\$491,590
<b>Total</b>	<b>\$97,694,849</b>	<b>\$106,644,816</b>	<b>\$115,053,387</b>	<b>\$128,436,295</b>	<b>\$144,978,496</b>	<b>\$146,366,306</b>

Source: Insurance Commission.

GRF = General Revenue Fund

\*Exam Fee 1 is an assessment fee for \$350 per company and Exam Fee 2 is an assessment fee of \$750 per company. The FY 2004 balance for Exam 2 was negative due to a one time \$2,500 assessment on insurers to help capitalize the West Virginia Physicians' Mutual Insurance Company. At the time of this report, the commission had collected all of the assessments that were due and remitted them to the company. The dramatic change in balances for Exam Fees-2 from fiscal year 2003 to fiscal year 2004 was due to the collection of the one-time assessment during fiscal year 2003 and its remittance during fiscal year 2004.

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## Uses of Revenues Collected By the Insurance Commission

The Insurance Commission contributes the largest share of funds collected to the General Revenue Fund. Table 4 is a summary of Insurance Commission contributions to various funds from fiscal years 1999-2004. Total revenues collected increased each year. During fiscal year 2004, the Insurance Commission distributed over \$146,000,000 to the General Revenue Fund, Fire Marshall's Office Budget, Insurance Commission's Budget, Municipal Police and Fire Pension, Volunteer Fire Department Fund, and the Teachers' Retirement Fund. Since fiscal year 1999, the Insurance Commission has deposited an average of 64% of funds collected into the General Revenue Fund while depositing the other remaining 36% into the other funds listed.

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*During fiscal year 2004, the Insurance Commission distributed over \$146,000,000 to the General Revenue Fund, Fire Marshall's Office Budget, Insurance Commission's Budget, Municipal Police and Fire Pension, Volunteer Fire Department Fund, and the Teachers' Retirement Fund.*

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The commission distributes the 3% tax on direct premiums written by insurers, the 1% annuity tax, a minimum tax of \$200 per insurer for those insurers with a tax liability less than \$200, 30% of examination fees and all penalty fees to the General Revenue Fund. The commission divides collections from the 1% premium tax on all fire and casualty insurance premiums and the 4% premium tax from Excess Line Brokers as follows: 65% to Municipal Police and Fire Pensions, 25% to Volunteer Fire Departments, and 10% to Teachers' Retirement. The Insurance Commission collects 0.5% tax on fire policy premiums to fund the budget of the Fire Marshall's Office. Two additional 0.5% surcharges on fire and casualty premiums exist to fund volunteer fire departments and the Teachers' Retirement System. Seventy percent of examination fees and the Cash Control Account fund the Insurance Commission's budget.



	1999	2000	2001	2002	2003	2004
<b>General Revenue Fund</b>	\$63,414,415	\$71,467,986	\$77,506,514	\$87,010,213	\$92,788,144	\$95,616,041
<b>Fire Marshal's Office Budget</b>	\$829,540	\$862,348	\$877,499	\$1,001,445	\$1,294,226	\$1,163,756
<b>Insurance Comm Budget</b>	\$5,041,922	\$5,480,085	\$6,524,275	\$5,941,558	\$8,378,975	\$5,739,992
<b>Municipal Pensions</b>	\$9,433,184	\$9,581,957	\$10,034,877	\$11,892,398	\$14,610,590	\$15,650,543
<b>Volunteer Fire</b>	\$10,576,338	\$10,731,830	\$11,207,271	\$12,673,251	\$15,639,118	\$15,903,819
<b>Teachers Retirement Fund</b>	\$8,399,449	\$8,520,609	\$8,902,951	\$9,917,430	\$12,267,443	\$12,292,155
<b>Total</b>	\$97,694,849	\$106,644,816	\$115,053,387	\$128,436,295	\$144,978,496	\$146,366,306
<i>Source: Insurance Commission.</i>						

## Conclusion

*While the commission takes relatively few actions against individual agents, most of these orders result in fines or license revocations, indicating serious offenses. The specific examples of criminal conduct suggests that criminal activity is taking place, and the Legislature may want to consider requiring all licensees to have a criminal background check to further protect the public.*

The Insurance Commission has historically been active with respect to disciplinary orders taken against licensed agents and companies. Historically, most disciplinary orders have taken the form of fines directed at companies for the late payment of filing fees and taxes. The policy regarding the use of the disciplinary process for late company payments has changed, resulting in fewer disciplinary orders affecting companies. Misrepresentation is the most common offense for which individual agents are disciplined. While the commission takes relatively few actions against individual agents, most of these orders result in fines or license revocations, indicating serious offenses. The specific examples of criminal conduct suggests that criminal activity is taking place, and the Legislature may want to consider requiring all licensees to have a criminal background check to further protect the public. The issue of criminal background checks is discussed in greater detail in Issue 2.

The commission collected an average of over \$81 million dollars during the period from fiscal years 1999-2004 for the General Revenue Fund.

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During the same period, the commission collected an average of \$123,195,692 annually to fund various state programs. The commission clearly fulfills an important revenue collection role for the state through its system of insurance taxes, fees and surcharges. Because of its important regulatory and revenue collection functions the Legislative Auditor recommends continuing the Insurance Commission.

*The commission collected an average of over 81 million dollars during the period from fiscal years 1999-2004 for the General Revenue Fund. During the same period, the commission collected an average of \$123,195,692 annually to fund various state programs.*

## **Recommendation**

1. *The Legislative Auditor recommends that the Legislature continue the Insurance Commission.*





# Issue 2

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## **The Insurance Commission Does Not Have the Statutory Authority to Conduct Criminal Background Investigations on Applicants for Insurance Licenses as Recommended By the United States Government Accountability Office and the National Association of Insurance Commissioners.**

### **Issue Summary**

Both the Government Accountability Office (GAO, formally called the General Accounting Office) and the National Association of Insurance Commissioners (NAIC) agree that conducting criminal background investigations on applicants for insurance licenses can protect the public from individuals with a history of dishonest behavior. The Office of the Insurance Commissioner provided a description of the process for verifying background information provided on license applications:

*Both the Government Accountability Office (GAO, formally called the General Accounting Office) and the National Association of Insurance Commissioners (NAIC) agree that conducting criminal background investigations on applicants for insurance licenses can protect the public from individuals with a history of dishonest behavior.*

*If an applicant for license answers “yes” to a background question on an application [indicating a criminal history], the applicant is responsible to provide all documentation available concerning the response. This information is forwarded to the Commission’s Legal Division for review to determine if an applicant is qualified for licensure. The Insurance Commissioner currently has no authority to perform background checks through the State Police to follow-up on applicants who have responded “yes” to background questions or to determine if applicants who answer “no” are responding appropriately.*

The Insurance Commission currently has no alternative to simply accepting the criminal background information provided by applicants, without any independent means of verifying this information.

### **Methods Currently Available to the Commission for Screening Applicants**

If a licensed agent had a criminal history but did not indicate this in answers to various background questions on the license application, and an outside source provided the commission with information indicating a criminal background, the commission:

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*We would attempt to confirm the conviction. Upon confirmation there may be a revocation of the license. Applications are often completed by company personnel and not the individual. If the information is incorrect and it was an error as opposed to intentional and the conviction would not preclude licensing, a monetary penalty is most often sought. In the event the nondisclosure is intentional or the felony would preclude a license, revocation is sought.*

This method of verifying an applicant's criminal background is contingent on receiving information from an outside source since the commission itself cannot conduct criminal background investigations.

When asked to describe the commission's process for communicating with other states in order to determine if an applicant for licensure has lost a license in elsewhere, the commission's representative stated:

*The control is determined by the method of applying, electronic or via the mail (hard copy). Either way requires a form of license verification be included in the application, prior to processing by the Insurance Commission. The majority of our license applications are received electronically via NIPR (National Insurance Producer Registry). In order to apply electronically, an agent must have an active license in their state of domicile (NIPR control). In addition, all participating states report disciplinary actions to the NIPR database. NIPR cross-checks each applicant with any disciplinary orders on record and includes the disciplinary history as part of the electronic application to the state. Applicants with a disciplinary action are reviewed by the commission's legal staff to determine whether a license should be granted. If an application is mailed in to the department, non-resident applicants are required to provide a copy of their valid license from their state of domicile as part of the application process. If a resident applicant was to apply who had been previously revoked by WV, they would be identified in our current database via their Social Security Number. As of May 04, NIPR made available the ability for states to use the disciplinary cross-check for hard copy applications too. However, this service requires additional IT programming on the commission's part and will be something we will make available as programming demands allow, but as of today is not available to our staff.*

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The commission does have access to disciplinary data from the NIPR for agents currently licensed in another state who apply for West Virginia licenses electronically, but does not yet have the capability to obtain this information for hard copy applications. Disciplinary data on applicants from West Virginia is maintained in the commission's own database. Disciplinary data does not, by itself, indicate criminal convictions.

## **Twelve States Have Passed Legislation Establishing Criminal Background Checks as Permitted By U. S. Public Law 92-544**

The National Association of Insurance Commissioners (NAIC) is currently in the process of developing a Model Law for each state to consider that recommends background checks for insurance agents as well as insurance company officers and directors. The Model Law recommends obtaining fingerprints from each applicant for the purpose of performing a background check through a law enforcement agency. The Criminal Justice Information Services Division of the Federal Bureau of Investigation (FBI) provides criminal history records. The FBI currently charges from \$16 to \$22 per person for conducting criminal background checks. A state-level law enforcement agency can conduct a more detailed state-specific criminal background check. The West Virginia State Police charges \$20 for such a background check. These costs could be paid by insurance license applicants. Currently, there are twelve (12) states that have passed legislation utilizing U.S. Public Law 92-544 which authorizes states to submit fingerprints to the FBI and obtain criminal history record information: Alaska, Arizona, California, Colorado, Idaho, Nevada, New Mexico, New York, North Carolina, Pennsylvania, Texas, and Washington.

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*Currently, there are twelve (12) states that have passed legislation utilizing U.S. Public Law 92-544 which authorizes states to submit fingerprints to the FBI and obtain criminal history record information: Alaska, Arizona, California, Colorado, Idaho, Nevada, New Mexico, New York, North Carolina, Pennsylvania, Texas, and Washington.*

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An NAIC memorandum dated December 5, 2002 summarized the FBI and U.S. Department of Justice's guidelines that states must follow when drafting legislation authorizing background checks. In order to comply with Public Law 92-544, state statutes must meet the following criteria:

- *A state statute must exist as a result of a legislative enactment;*
- *The state statute must require the fingerprinting of applicants who are to be subjected to a national criminal background check;*
- *The state statute must expressly ("submit to the FBI") or by implication ("submit for a national check"), authorize the use of FBI records for the screening of applicants;*
- *The state statute must identify the specific category of*

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*licensees/employees falling within its purview, there by avoiding overbreadth;*

- *The state statute must not be against public policy; and*
- *The state statute may not authorize receipt of criminal history information by a private entity.*

State-level law enforcement agencies must first conduct a background check, before the FBI does, as the NAIC memorandum further states:

*As part of this policy, the FBI requires that fingerprints be initially submitted to, usually the Department of Law Enforcement, Public Safety or Criminal Justice for a check of state records before the fingerprints are forwarded to the FBI for a criminal history check.*

## **A Government Accountability Office Report Calls for Background Checks**

A July 2004 GAO report entitled “*Better Information Sharing Among Financial Services Regulators Could Improve Protections for Consumers*” reviews the need for insurance regulators to have more access to FBI nationwide criminal history data. The report stated:

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*In testimony before two subcommittees in March 2001, a GAO representative stated, “Among all financial regulators, only those regulating insurance lacked the ability to routinely access national criminal history data for the purpose of screening potential industry entrants.”*

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*According to information obtained from state regulators and the FBI, fewer than one-third of the states have taken actions that current federal law requires for them to have such authority. Consequently, regulators in other states cannot be sure that they are protecting insurance consumers from fraud by keeping individuals previously convicted of serious criminal behavior out of the business of insurance.*

In testimony before two subcommittees in March 2001, a GAO representative stated, “*Among all financial regulators, only those regulating insurance lacked the ability to routinely access national criminal history data for the purpose of screening potential industry entrants.*” It is the goal of the NAIC and the GAO to have uniform state regulation in place so that there is no “*rogue migration*” which involves an individual moving to another state and “*... lying on an application and beginning again to engage in unscrupulous activities.*”

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## The Insurance Commission Cannot Utilize the State Police or the FBI for Criminal Background Checks

The West Virginia Insurance Commission does have questions on license applications concerning legal issues. The West Virginia Insurance Application for a Resident or Non-Resident Producer's License includes fourteen questions the applicant must answer, some of which are related to criminal behavior, and requires a \$25.00 license fee. Examples of questions include:

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*Once the Insurance Commission receives the response, it is up to the commission's legal division to review if the applicant is qualified for licensure. Regardless of the manner in which an applicant answers questions, the commission is limited in its ability to verify the information provided.*

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- *Have you ever been charged by an insurance agency or company with financial irregularities?*
- *Have you ever been indicted or convicted of a felony or misdemeanor?*
- *Have you ever been penalized or fined, had a license denied, refused, suspended or revoked by this department or the insurance department of any other state?*
- *Do you have a child support obligation?*
- *Are you the subject of a child support-related subpoena or warrant?*

Once the Insurance Commission receives the response, it is up to the commission's legal division to review if the applicant is qualified for licensure. Regardless of the manner in which an applicant answers questions, the commission is limited in its ability to verify the information provided. According to the Insurance Commission, it has:

*...no authority to perform background checks through the State Police [this would also apply to the FBI] to follow up on applicants who have responded yes to background questions or to determine if applicants who answer no are responding appropriately.*

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*Since examples of illegal conduct among licensees clearly exist, it is possible that such individuals previously had criminal backgrounds and still obtained licenses in West Virginia after providing false information on their applications.*

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The Legislative Auditor obtained data from the Insurance Commission on agent disciplinary orders from 1999-2003. There have been documented cases of license revocation due to misappropriation of funds, misrepresentation on applications, felony and forging signatures, (see Issue 1). Since examples of illegal conduct among licensees clearly exist, it is possible that such individuals previously had criminal backgrounds and still obtained licenses in West Virginia after providing false information on their applications. In the future, the Insurance Commission may want to consider background checks for new applicants, and for existing agents upon renewal of the license to further protect the public. **Because of the criminal conduct of licensees documented in Issue 1 and the potential for individuals to provide false information on license applications, the Legislative Auditor recommends that the**

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**Legislature consider amending the West Virginia Code to enable the Insurance Commission to conduct criminal background checks, through both the State Police and the Federal Bureau of Investigation, on all applicants for insurance licenses, on all applicants for new insurance licenses and existing licensees at the time of license renewal.**

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*Currently the West Virginia Code does not allow the Insurance Commission to use fingerprinting as a means of conducting criminal background checks or to utilize the FBI or State Police.*

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*Failing to use the State Police or the FBI for the purpose of conducting background checks may permit dishonest agents to practice in this state.*

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## **Conclusion**

Currently the *West Virginia Code* does not allow the Insurance Commission to use fingerprinting as a means of conducting criminal background checks or to utilize the FBI or State Police. According to U.S. Public Law 92-544, a state statute must be in place to utilize the FBI as the source of criminal background data. Currently 12 states have passed legislation that follows the criteria set forth in Public Law 92-544. According to the West Virginia Insurance Commission, it has “...no authority to perform background checks through the State Police to follow up on applicants who have responded yes to background questions or to determine if applicants who answer no are responding appropriately.” Failing to use the State Police or the FBI for the purpose of conducting background checks may permit dishonest agents to practice in this state. It is the Legislative Auditor’s opinion that the Legislature should consider amending Chapter 33 of the *West Virginia Code* to enable the Insurance Commission to use fingerprinting as a means of background checks through the Federal Bureau of Investigation’s database.

## **Recommendation:**

2. *The Legislative Auditor recommends that the Legislature consider amending the West Virginia Code to enable the Insurance Commission to conduct criminal background checks, through both the Federal Bureau of Investigation and the State Police, on all applicants for new insurance licenses and existing licensees at the time of license renewal.*

# Appendix A: Transmittal Letter

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## WEST VIRGINIA LEGISLATURE *Performance Evaluation and Research Division*

Building 1, Room W-314  
1900 Kanawha Boulevard, East  
Charleston, West Virginia 25305-0610  
(304) 347-4890  
(304) 347-4939 FAX



John Sylvia  
Director

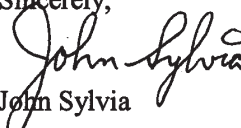
January 20, 2004

Ms. Jane L. Cline, Insurance Commissioner  
West Virginia Office Of The Insurance Commissioner  
1124 Smith Street P.O. Box 50540  
Charleston, WV 25305-0540

Dear Ms. Cline:

This is to transmit a draft copy of the Preliminary Performance Review of the West Virginia Insurance Commission. This report is scheduled to be presented during the February 6-8, 2005 interim meeting of the Joint Committee on Government Operations. We will inform you of the exact time and location once the information becomes available. A representative from your agency should be present at the meeting to orally respond to the report and answer any questions the committee may have.

We would like to schedule an exit conference to discuss any concerns you may have with the report. We would prefer to meet Thursday January 27, 2005. We need your written response by noon on Tuesday, February 1, 2005 in order to include it in the final report. If your agency intends to distribute additional material to committee members at the meeting, please contact the House Government Organization staff at 340-3192 by Thursday, February 3, 2005, to make arrangements. Thank you for your cooperation.

Sincerely,  
  
John Sylvia

JS/bb

Enclosure

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*Joint Committee on Government and Finance*





# Appendix B: Penalty Matrix

AUTHORITY (W.VA. CODE) PENALTY	INFRACTION
INSURER LICENSE§33-3-1(e)(1957-2001)§33-43-7 (2001) Misdemeanor: ≤\$10K and/or 1 yr. 33-43-7(a) \$25.00 per day failure to file33-43-7(b) 1% of liability failure to pay	Insurer licensing requirements
REVOCATION/SUSPENSION OF LICENSE§33-3-11(b) (1957) Miscellaneous insurance act violations	≤\$10K
FEES AND CHARGES§33-3-13 (1957) Fees collected can be designated for use by Department	
PREMIUM TAX§33-3-14c (1983-2001)§33-43-7 (2001) \$100 per day33-43-7(a) \$25.00 per day failure to file33-43-7(b) 1% of liability failure to pay	Failure to pay estimated/quarterly tax
RETALIATORY LAW§33 316 higher penalties on W.Va. insurers than are imposed on its own domestic insurers, then W.Va. imposes the same on insurers from that state doing business here.	<u>Retaliatory law</u> : If another state imposes
UNAUTHORIZED INSURER§33-3-24 (1992-2001)§33-44-7 (2001) Unauthorized insurance transactions	≤\$20K per occurrence≤\$20K per occurrence
PROHIBITED PRACTICE§33-3-30 (1992-2001)§33-44-7 (2001) Prohibited practice by insurer	≤\$1K per act up to \$20K≤\$20K per occurrence
ADMINISTRATIVE FINE§33-3-32 (1992-2001)§33-44-7 (2001) Violation of order	≤\$5K per violation≤\$20K per occurrence
SURCHARGE§33-3-33 (1997) \$100 per day	Failure to collect
GENERAL PROVISIONS§33-4-8 Misdemeanor: ≤ \$1K and/or ≤6 mos.	Failure to comply
DOMESTIC STOCK AND MUTUAL INSURER§33-5-19 Liable for loss to insurer	Illegal dividends
DECLINATION OF AUTO§33-6B-6 ≤\$5K	Improper declination
REHABILITATION AND LIQUIDATION§33-10-5(b) Misdemeanor: ≤\$1K and/or ≤1 yr.	Failure to deliver seized records or assets
UNFAIR TRADE PRACTICE ACT (UTPA)§33-11-4(9)(o) Interest on amount of claim @ prime rate + 1%	Unfair claim settlement
UNFAIR TRADE PRACTICE ACT (UTPA) §33-11-6 \$1K per violation up to \$10K, unless willful\$5K per violation up to \$50K per six months	Unfair trade practice
UNFAIR TRADE PRACTICE ACT (UTPA)§33-11-8 ≤\$10K per violation	Violation of cease & desist order
AGENTS AND BROKERS§33-12-25 ≤\$1K or revocation or suspension	Miscellaneous agent violations
ADJUSTERS§33-12B-11 (1988) ≤\$1K	Adjuster license requirements
MARKETING AND RATES§33-16D-4(c) ≤\$10K	Marketing discrimination
LIMITED BENEFITS§33-16E-8(a)(1) reporting failure	Accident and Sickness insurance - \$2,500 + \$2,500 per month continuing
LIMITED BENEFITS§33-16E-8(a)(2)	Accident and Sickness insurance -

reporting inaccuracy	\$2,500 + \$2,500 per month continuing
LIMITED BENEFITS§33-16E-8(a)(3)	Accident and Sickness insurance - failure
to correct premium	\$5K + \$5K per month continuing
PROPERTY INSURANCE§33-17A-8	Improper declination
≤\$5K per willful violation	
MALPRACTICE RATES§33-20B-6(b) (1986)	Rate review reporting requirements
\$10K for each of first 5 failures, \$100K each for 6 <sup>th</sup> and subsequent per year	
MALPRACTICE SETTLEMENT§33-20B-8(c)	Failure to report result of civil action
against doctor	\$1K - \$10K per occurrence
TAIL INSURANCE§33-20D-3(d)	Failure to offer
Amount of premium due	
FARM MUTUALS§33-22-4 (1957)	Exceeding licensed authority
≤\$10K (33-3-11)	
FRATERNAL BENEFITS§33-23-8 (1957)	Exceeding licensed authority
≤\$10K (33-3-11)	
HEALTH SERVICE CORPORATION§33-24-5(d)	Exceeding licensed authority
≤\$10K (33-3-11)	
HEALTH SERVICE CORPORATION§33-24-17(b)	Failure to deliver seized records or assets
Misdemeanor: ≤\$1K and/or ≤1 yr. jail	
HEALTH CARE CORPORATION§33-25-7(f)	Licensing infraction
≤\$1K	
HEALTH MAINTENANCE ORGANIZATION (HMO)§33-25A-14(9)	
Prohibited practice	1 yr. subscription rate + costs and attorney
fees	
HEALTH MAINTENANCE ORGANIZATION (HMO)§33-25A-23(1)	
Act violation by insurer	\$100 - \$5K + damages to public
HEALTH MAINTENANCE ORGANIZATION (HMO) §33-25A-23(2)	
Act violation by person	Misdemeanor: \$1K-\$10K and/or ≤1 yr jail
PREPAID LIMITED HEALTH SERVICES§33-25D-25(a)	Act violation by insurer
\$100 - \$5K + damages to public	
PREPAID LIMITED HEALTH SERVICES§33-25D-25(b)	Act violation by person
Misdemeanor: \$1K-\$10K and/or ≤1 yr jail	
GUARANTY ASSOCIATION§33-26-10(2)(b)	Failure to pay assessment
≤5% of unpaid assessment per month	
GUARANTY ASSOCIATION LIFE AND HEALTH§33-26A-11(b)	
Failure to pay assessment	≤5% of unpaid assessment per month, but
not less than \$100 per month	
INSURANCE HOLDING COMPANY§33-27-9(a)	Failure to file statements - by insurer
≤\$1K per day	
INSURANCE HOLDING COMPANY§33-27-9(b)	Failure to file statements - by officer
≤\$5K	
INSURANCE HOLDING COMPANY§33-27-9(d)	Any violation of article
By Insurer: ≤\$10KBy person: misdemeanor ≤\$10KBy person if willful fraud: felony, ≤\$10K and/or 1-3	
ysr jail	
RISK RETENTION ACT§33-32-20	Act violations
Discretionary penalty	
FAILURE TO REPORT IMPAIRMENT§33-35-3(a)	Failure to report impairment
Misdemeanor: ≤\$50K and/or ≤1 yr jail	

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FAILURE TO REPORT IMPAIRMENT§33-35-3(b) Felony: ≤5 yrs. prison	Miscellaneous impairment violations
PRODUCER CONTROLLED INSURER§33-36-7(d) Discretionary penalty	Act violations
MANAGING GENERAL AGENT (MGA)§33-37-6 \$1K per violation + reimburse	Miscellaneous violations
REINSURANCE INTERMEDIARY§33-38-11 ≤\$5K	Act violations
WOMEN’S ACCESS §33-42-8 Felony: \$10K-\$50K and/or ≤2 yrs. jail	Partial birth abortion
TAX PROCEDURES ACT§33-43-7(a) and (b) (a)\$25 per day(b) 1% of assessed liability	Act violations
UNAUTHORIZED INSURER§33-44-7§33-44-9 ≤\$20K per actFelony: \$20K per act and/or 1 ≤5 yrs. jail	Act violations

07/02 Revision G:\Jack\Violations and Penalties\Paul’s Chart.wpd



# Appendix C: Agency Response

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STATE OF WEST VIRGINIA

Offices of the Insurance Commissioner

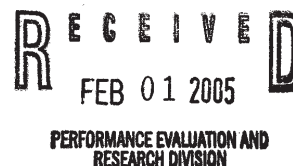
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**JOE MANCHIN III**  
Governor

**JANE L. CLINE**  
Insurance Commissioner

February 1, 2005

John Sylvia  
West Virginia Legislature  
Performance Evaluation and Research Division  
Building 1, Room W-314  
1900 Kanawha Boulevard, East  
Charleston, WV 25305-0610



**Re: Written response to Performance Review report of the  
West Virginia Offices of the Insurance Commissioner**

Dear Mr. Sylvia:

The Insurance Commission has thoroughly reviewed your Performance Review report of our agency. We are pleased with your recommendation to the Legislature that the Insurance Commission continue its functions of providing important regulatory protections to the citizens of West Virginia. The Commission does provide vital regulatory and revenue collection functions that provide significant support to the General Revenue Fund, municipal policemen and firemen pensions, volunteer fire departments, the teachers' retirement system, and the Offices of the Fire Marshal. We continue to incorporate new technologies as they become available to obtain the benefits of lower operating costs, stronger cash-management practices, and make our market more attractive to insurers for the benefit of residents of West Virginia.

The report accurately points out that "currently the West Virginia Code does not allow the Insurance Commission to use fingerprinting as a means of conducting criminal background checks or to utilize the FBI or State Police". The report concludes with the recommendation that the Legislature consider amending the West Virginia Code to allow fingerprinting as an additional means of regulatory review. The Insurance Commission is actively working with the National Association of Insurance Commissioners (NAIC) on this matter. The Producer Licensing Working Group of the NAIC is developing a Model Law which each state's legislature may consider for adoption. The Model Law will set forth the requirements for states to obtain access to the Criminal Justice Information Services Division of the Federal Bureau of Investigation. Access will allow criminal history record information, secure information, or reports from the Criminal Justice Information Services Division of the Federal Bureau of Investigation. Under the proposed provisions of the Model Law each state will obtain fingerprints of resident applicants for licenses and submit them through a law enforcement agency for a background check. While the Insurance Commission agrees with the recommendation of the report we recommend waiting until the model law is finalized later this year to assure continuity with other states insurance regulators.

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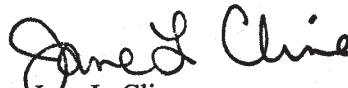
Telephone (304) 558-3029  
Facsimile (304) 558-0412  
[www.wvinsurance.gov](http://www.wvinsurance.gov)

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John Sylvia  
Re: Performance Review Report  
February 1, 2005  
Page Two

I appreciate the courtesy your staff extended to our offices while performing their review. Their professionalism and understanding of the other demands on the Commission's personnel made the review proceed smoothly with little interruption to our operations. If I can provide any additional information, please let me know.

Sincerely,

  
Lane L. Cline  
Commissioner

JLC/MR/kb