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CHRISTINA URIAS
Director of Insurance

February 24, 2009

The Honorable Jorge Garcia
Arizona State Senate

The Honorable David Lujan
Arizona House of Representatives

1700 W. Washington
Phoenix, AZ 85007

RE: Arizona Department of Insurance Budget Issues

Dear Senator Garcia and Representative Lujan:

We welcome the opportunity to respond to your inquiry regarding the impact of the fiscal year (FY) 2009 budget cuts on state agencies and the potential effects of additional cuts in FY 2010. Please note that before these most recent budget reductions, the Arizona Department of Insurance (ADOI) was already operating at a 15% staff reduction to meet last year's budget reductions (\$435,500 of our \$7,800,800 appropriation), operating with only 90 of our 106.5 General Fund positions filled. As detailed below, ADOI recently separated an additional 25% of our General Fund workforce and placed all remaining ADOI employees on 18-day furloughs for the remainder of this fiscal year. Our FY2009 General Fund appropriation was \$7,369,700; SB1001, enacted January 30, 2009, required ADOI to cut another \$952,900 by June 30, 2009.

Program Funding

The SFY 2009 budget cuts do not include specific program funding cuts for ADOI. The fund transfers, however, include \$25,500 from the Captive Insurance Regulatory and Supervision Fund (Captive Insurance Program) and a total of \$404,200 from the Insurance Examiners' Revolving Fund (Solvency Regulation Program).

Reduced or Eliminated Services

Our budget reduction impacts every area of our regulatory operations and responsibilities; significantly reducing the protection we afford to Arizona insurance consumers and reducing our oversight of insurance professionals, insurance

companies and a variety of other insurance-related entities that we license, monitor and regulate to assure compliance with Arizona law.

Consumer Services

ADOI's reduction in force will have a drastic impact on our Consumer Affairs Division (CAD). These CAD employees are on the front lines of communications with ADOI consumers who initiate an average of 50,000 insurance inquiries and complaints each year, via phone, e-mail, regular mail, and walk-in requests. Following the AIG crisis last fall, CAD received 1,600 consumer phone calls in 8 days. In SFY 08, consumer assistance personnel answered roughly 45,000 telephone inquiries, processed over 5,000 written complaints and personally assisted roughly 500 walk-in consumers with their insurance problems. CAD employees are instrumental in reversing a variety of improper insurance transactions, obtaining on average between \$6 and \$7 million a year in recoveries for Arizona consumers. Recent budget reductions forced ADOI to eliminate 7 CAD employees – nearly half of our consumer services staff – which will likely reduce annual consumer recoveries by half (\$3.5 million) next year, exacerbate complaint handling delays and dramatically increase telephone “on-hold time.”

Insurance Fraud Unit

Recent budget reductions also forced ADOI to eliminate 9 positions (7 special agents, 2 administrators) in our Fraud Unit, leaving 2 special agents to handle consumer fraud investigations. These 2 special agents and one special agent supervisor, working 80% of the time because of our 18-day furloughs, will be unable to investigate an average of approximately 200 insurer fraud referrals we receive every month. In SFY 08, the Fraud Unit received 2,163 insurance fraud referrals, but resource limitations limited investigations to approximately 315 of those cases. These recent cuts will reduce the number of investigations and insurers will become increasingly dissatisfied with our inability to investigate cases that Arizona requires insurers to report to us.

In SFY 08, the Fraud Unit recovered \$2,250,469 in restitution and saved insurers another \$650,274 in fraud-related costs. With 3 investigators, we will not be able to obtain substantial insurer recoveries and will no longer have effective means to combat insurance fraud in Arizona. Note also that Arizona insurers pay assessments to the General Fund to fund the Fraud Unit (ARS § 20-466(J)).

Financial Affairs Division

We also eliminated 4 administrative support positions in our Financial Affairs Division (FAD). These employees contributed to overall FAD operations, including our ability to process insurer annual financial statements, process insurance company license applications, process general financial business filings from licensed insurers, monitor and enforce compliance with trust deposit requirements comprising a \$3-billion portfolio of securities held by the Arizona State Treasurer, and process insurer premium tax returns. The loss of these employees, combined with the 18-day furloughs for all remaining FAD employees, will delay FAD's financial solvency oversight and licensure responsibilities and will delay tax revenue deposits to the General Fund.

Tucson Office

Effective February 20, 2009, we closed our Tucson office (originally established in 1960-1961). This office handled agent/producer licensing, consumer inquiries and complaints for our Southern Arizona constituents. Previous reductions reduced staff at this office, and with this recent reduction in force, we eliminated the last remaining Tucson employee and closed the office.

Insurance Professional Licensing

As of December 31, 2008, Arizona had 158,263 licensed insurance agents/producers. The Insurance Licensing Section annually processes over 46,000 license and renewal applications and assists over 35,000 callers with licensing-related questions. The 18-day furloughs of Licensing Section employees will create scheduling challenges that will reduce the number of employees available to handle and respond to telephone calls resulting in telephone "on-hold" delays. Although we will continue to use our online license and renewal application service, not all applicants can use online services because many applications require additional documentation before ADOI grants or renews an insurance license.

Policy Form, Rate and Advertising Filings

There are approximately 2,000 insurance companies licensed to do business in Arizona. To protect Arizona consumers, assure financial solvency and insurer compliance with Arizona law, ADOI's Property and Casualty Division and Life and Health Division review and analyze insurance policies, rates, forms, marketing and underwriting practices. Budget reductions forced us to eliminate 4 employees from these divisions (2 from each division) and the remaining staff is only working 80% of the time due to the 18-day furloughs. For many types of insurance company policy/rate filings, Arizona law imposes time limits within which ADOI must disapprove a filing, otherwise, the insurer's filing is "deemed" approved. Without sufficient staff to conduct timely reviews, we estimate approximately 20% of insurance company filings will be "deemed" approved without review. Consequently, insurance policies that fail to contain required provisions, or that contain prohibited or unlawful content, or insurance rates that are excessive, insufficient, or unfairly discriminatory, or misleading advertising that misrepresents insurance products may all be "deemed" approved, because we simply no longer have sufficient staff.

Federal Matching Fund

ADOI does not receive any federal matching funds.

Reduction in Force

Effective February 20, 2009, we implemented a reduction in force of 22 ADOI employees and eliminated 2 uncovered employees. We are down to 64.25 filled General Fund FTE positions; 40% less than the 106.5 FTE's we were originally appropriated for FY2008 — less than the 78 FTE positions we had 20 years ago in FY1989, while the growth in Arizona's insurance market over the past 20 years has been constant.

The following is the breakdown by division of ADOI's most recent reduction in force and layoffs:

Consumer Affairs Division

5 Consumer Services Specialists I (including the one from Tucson)
2 Consumer Services Specialists II

Investigations Division (Fraud Unit)

7 Special Agents
1 Administrative Services Officer III
1 Administrative Assistant I

Financial Affairs Division

2 Clerk Typists III
1 Secretary
1 Administrative Secretary I

Property and Casualty Division

1 Administrative Services Officer I
1 Clerk Typist II

Life & Health Division

1 Managed Care Program Manager (uncovered – layoff)
1 Life and Health Administrative Officer (uncovered – layoff)

Anticipating budget reductions at the outset of FY2009, ADOI also implemented the following layoffs last August:

Life & Health Division

1 Senior Insurance Analyst
1 Life and Health Administrative Officer (reduced to half-time)

Market Conduct Division

1 Market Oversight Administrator

Financial Affairs Division

1 Legal Analyst

Furloughs

On February 9, 2009, we announced implementation of ADOA's pilot furlough program for all full-time covered employees. Between February 9 and May 1, all full-time covered employees will be on furlough for 12 days. After the SB1003's effective date, those employees will be on furlough for an additional 6 days between May 2 and June 12. Virtually all ADOI uncovered FTEs will also be on 18-day furlough between February 9 and June 12.

Salary Reductions

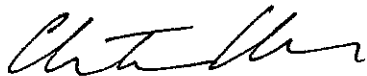
We are not contemplating any salary reductions at this time beyond those incident to the furlough.

Potential Effects of Additional Budget Cuts in FY 2010

Even before the current fiscal crisis, ADOI has always been vigilant by limiting staffing and other costs. When the economy began to turn downward in the beginning of FY 2008, we immediately instituted a hiring freeze (before the Governor's official action) and eliminated non-essential expenditures in anticipation of future budget reduction requirements. When I started my tenure as Director over 5 years ago, I had a staff of 138 employees. I now have 96.5. Another reduction in force and extended furloughs would be the only means of addressing any additional budget cuts to ADOI, leaving Arizona without a functional insurance department.

Thank you for your concern and attention to our budget situation. Please advise if I can answer any questions or provide further information.

Sincerely,



Christina Urias
Director