

OFFICE OF THE STATE AUDITOR

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AUSTIN, TEXAS 78701

LAWRENCE F. ALWIN, CPA
State Auditor

December 11, 1996

The Honorable George W. Bush
Governor of Texas
Governor's Office
State Capitol, Room E1.304
Austin, Texas 78701

Dear Governor Bush:

The Texas Health Reinsurance System (System), effective September 1, 1995, is operating according to statute (V.T.C.S. Insurance Code, Article 26) and its Plan of Operation. It is governed by a Board of Directors (Board), whose nine members are appointed by the Commissioner of Insurance. In addition, the Board and the Department of Insurance (Department) have the necessary controls to ensure efficient and effective management of the System.

No public funds are at risk in the System because it is financed by reinsurance premiums and carrier assessments, and the assessments do not qualify as offsets to premium taxes. As of September 1, 1996, the System had 44 small-employer insurance carriers, with 18 group and 52 individual health plans reinsured (a total of 168 individuals).

Our recommendations concerning the System are as follows:

System Board of Directors

Amend the Plan of Operation to include System requirements for reinsured carriers to provide their own audits. This Plan of Operation provision will serve as notice and explanation to reinsured carriers. The Board may also wish to consider tracking loss ratios for the reinsured carriers to help evaluate System performance.

Department of Insurance

Consider asking the Legislature to change the two-year, non-staggered terms for the Board of Directors to two- or three-year staggered terms. Under current statute, unless a Board member agrees to serve another term, a new Board is created every two years.

Consider appointing a small carrier to the Board of Directors when a private-industry vacancy occurs. The five private-industry members currently serving the Board are from medium and large companies, but more small companies participate in the System.

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Audit Objectives, Scope, and Methodology

The State Auditor's review of the Texas Health Reinsurance System was conducted in accordance with V.T.C.S. Insurance Code, Article 26.57(a). The audit objectives were to evaluate System compliance with Texas statutes and its Plan of Operation and to identify any opportunities to improve the efficient and effective operation by the Board of Directors and the Department of Insurance. We did not review the administering carrier (third-party administrator) or the reinsured carriers because they are already subject to independent audit.

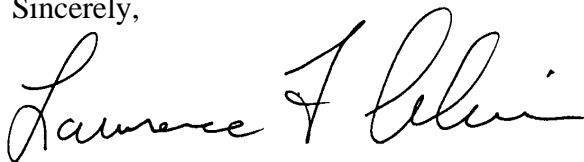
To accomplish our audit objectives, we:

- Reviewed Texas statutes and the System's Plan of Operation
- Reviewed documentary evidence provided by the Department and the administering carrier
- Interviewed Board members and Department personnel
- Conducted the review in accordance with Generally Accepted Government Auditing Standards

The Board's and the Department's response to our report and acceptance of our recommendations are attached.

We appreciate the cooperation of the Board of Directors and the Department of Insurance staff during this audit. If you have questions or need additional information please call Bernie Gilmore, Audit Manager, at (512) 479-4785.

Sincerely,



Lawrence F. Alwin, CPA
State Auditor

LFA/rmn

cc: Mr. Elton Bomer, Commissioner of Insurance - Texas Department of Insurance
Mr. Bruce A. Bradley, Chair, Board of Directors - Texas Health Reinsurance System