THE REGULATOR™
INSURANCE REGULATORY EXAMINERS SOCIETY

Is Speed-to-Market racing too fast for consumers?

By Scott Hoober
REGULATOR staff writer

Insurance regulation has never been a stranger to change, but lately the changes have been coming along faster and more furiously than ever before.

On the heels of last year's Gramm-Leach-Bliley Act (GLBA) comes speed-to-market.

The idea, as the name implies, is to allow insurers to move new products to market with greater speed — giving them an edge in the new, more competitive financial services world. The impetus behind speed-to-market goes way beyond GLBA, though, to a long-term trend in insurance regulation: keeping the 50-plus insurance departments relevant in an era of national — not to mention international — insurance companies.

Joel Ario, deputy commissioner of the Oregon Insurance Division, looks at the nation's regulatory system as having 50 or more points of entry when it comes to review of insurance products.

"When you look at it that way," says Ario, "I think you see problems from the consumer's perspective, from the regulator's perspective and from the industry's perspective."

From SERFF to CARFRA

Since the state-by-state regulatory framework has a great many strengths, the solution clearly is to overlay as much uniformity as possible. The ideal? Making life easier for one constituency, the companies,

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Progressive: What Happened?

By Brian Sullivan

It isn't easy to be Glenn Renwick these days. He took over as CEO of insurance operations at Progressive Insurance in January and has had to contend from day one with a string of headaches. Not only has the company missed Wall Street's earnings forecasts for the better part of a year, the company has missed its own pre-release statements about how it would miss growth targets. On top of that, a reorganization resulted in scores of top jobs being eliminated. In addition to shedding some employees who might not have been at the top of their game, a number of talented product managers also jumped the rocking ship, landing better jobs at bigger pay. Ouch.

But blame not the new top dog. In fact, blame no one. Progressive's current tight spot is the natural outcome of an extraordinary run of

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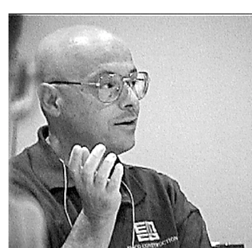
From the President

Don't sit on the sidelines

As the Meetings and Elections chairperson last year, I was responsible for verifying the results of our Board of Directors elections. Not having ever done this before, I was very disappointed to find out that less than 25% of our membership even bothered to vote. I would like to see an increase in the number of members voting this year.



We all should take a greater interest in **our** organization.While federal legislators debate the role of state regulation in the 21st Century, organizations like ours can play an important role, provided we have an active and informed membership. Remember, as a society we are only as good as the sum of our parts. How can you participate? There are many ways.

IRES has seven standing committees chaired by members of the Executive Committee. We are always looking for volunteers to serve on the committees. These committees conduct their business through telephone conference calls and e-mail. It's a great opportunity to meet other members and learn more about IRES.

Another way to become involved is to serve on one of the Educational Committee Sections that is already working on ideas and topics for the 2001 Baltimore CDS. A lot of work and effort goes into making our seminars so success-

ful—be part of it. I can speak from personal experience last year as a member of the Consumers Services Section, chaired by Paul Bicica. We were able to recruit several new members for our Committee, which generated a wealth of fresh ideas and topics. Paul designated each committee member with the responsibility of handling one session—it was their responsibility to make sure that speakers and moderators were on board and that sessions ran smoothly. From my perspective it was the best organized seminar in years.

Almost every regulator is an expert in some field. Why not write about it? The Publication Committee and the editor of *The Regulator* are always looking for original material that can be published in the IRES newsletter. Share your thoughts, story ideas or manuscripts with Pamela Donnewald or Wayne Cotter. You should also be aware that if you are researching a particular topic, past issues of *The Regulator* are now available on our Web site, along with a handy subject index.

We also are looking to put our Board of Directors and Executive Committee minutes on our Web page in an effort to keep our members informed. This promises to be an exciting year for insurance regulation and IRES. Don't sit on the sidelines. Participate! We welcome your ideas and suggestions, but most of all we welcome ***your participation***.

IRES PRESIDENT

C.E. News

DID YOU MISS THE CE DEADLINE?

Designees who missed the October 1 deadline for reporting required continuing education credits during the annual compliance period (Sept. 1, 1999 to Sept. 1, 2000) will soon be receiving notices from the IRES CE Office that IRES will no longer recognize their designation.

To be automatically reinstated, designee holders must certify all past CE hours and pay a $60.00 reinstatement fee. Those who filed extensions prior to the deadline have one year to complete the required CE hours.

If insufficient CE hours were earned during the compliance period, a written appeal for reinstatement must be made in writing to the Accreditation & Ethics Committee in care of the IRES CE Office.

NEXT REPORTING DEADLINE IS OCT. 1, 2001

More questions? Call us at 913-768-NICE

N · I · C · E

Is Speed-to-Market Moving Too Fast?

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without harming the interests of the other constituency, the public at large.

SERFF (System for Electronic Rate and Form Filing) as well as steps toward uniformity in agent-broker licensing are both attempts to move states toward a more uniform approach. The latest move in that direction is speed-to-market and a corollary initiative known by the acronym CARFRA — short for Coordinated Advertising, Rate and Form Review Authority.

Speed-to-market in its narrowest sense can mean one state's solo efforts to hasten the product review process. In its broadest sense, though, it's a movement that brings states together to develop common approaches to reach the same goal — and the uniformity that comes from working jointly has obvious advantages. CARFRA, an initiative by the National Association of Insurance Commissioners (NAIC) that already involves six states, is an example of speed-to-market in its broadest sense.

A second speed-to-market subgroup is looking at improvements in the current state-based system.

Lee Covington, director of insurance for Ohio, chairs the Improvements to State-Based Systems Subgroup. This subgroup is charged with looking into commercial lines rate deregulation — a particular bugaboo of Hunter and other consumer advocates — as well as expansion of electronic rate and form filing and other issues, such as uniform consumer education programs and market conduct exams.

When you think of it in that context, speed-to-market is a move (perhaps even a belated move) in the right direction. And who could argue with that?

Well, Robert Hunter for one. "The NAIC plan will gut many vital consumer protections offered by state insurance departments," he declared during a news conference held during NAIC's September meeting in Dallas.

Hunter, insurance director for the Consumer Federation of America and former Texas commissioner, has issued a 17-page white paper listing pro-consumer changes he feels are needed — a paper that's been endorsed by the AFL-CIO, the Consumers Union and the Center for Insurance Research.

As Hunter puts it in this issue of *The Regulator,* "It's clear that consumers need better and smarter regulation, not less regulation."

On the other side of the issue are the likes of the American Council of Life Insurers (ACLI), which says that inefficient insurance regulation is making it impossible for its members to compete with mutual funds, commercial banks and the like.

"Historically, life insurers competed only against other life insurers," ACLI chairman Drayton Nabers Jr. told a Congressional committee a couple of months ago.

"Whatever the inefficiencies of insurance regulation, companies incurred them equally. . . . The status quo, while often frustrating, did not present insurers with serious competitive problems," added Nabers, chairman and CEO of Protective Life Insurance Co.

Hopefully, reality will fall somewhere in between these two extremes, with insurers' lives made simpler, but not at the expense of consumers.

Moving right along

In New York, one of the six CARFRA states, a number of checklists are available that insurers can use to determine if a proposed product is likely to pass regulatory muster. Once a company officer certifies to the accuracy of its checklist, the review time for the product is considerably shortened. Back-end reviews, conducted after the product hits the marketplace, will also be conducted.

Ultimately, any insurance commissioner could choose to participate in CARFRA, contributing staff members who would stay home but take part electronically in revolving review teams.

Frank M. Fitzgerald, Michigan's financial and insurance services commissioner, and Diane Koken, Pennsylvania commissioner, chair NAIC's Speed-to-Market Working Group, which is responsible for both the speed-to-market pilot and CARFRA.

There's some question whether much of this movement is really based on GLBA. After all, if a bank or brokerage chooses to offer insurance products, they'd be regulated just as if they were being offered by an insurance company.

Undoubtedly, there's a serious acceleration in the long-term trend to shape up and speed up insurance regulation. While the public may wish for a decrease in pointy-headed bureaucrats, there are legitimate reasons to be concerned how well consumers will be served by new forms of insurance regulation. And regulators, too, may be forgiven for wondering whether change of this magnitude is truly of value — to consumers, or to their own continued employment.

Local markets

The essence of state-by-state regulation is that every state is a little different from its peers. Who knows what residents of West Virginia or Idaho or Texas or Oklahoma need better than regulators working for those states, and responsive to those states' legislatures?

Is Speed-to-Market Moving Too Fast?

The argument today is that the nation is becoming a single market, with more in common than ever before.

Maybe the local market still rules in some insurance products — homeowners, auto and health come immediately to mind — but for many other lines the new way of looking at things seems to make sense.

"If you think about a product like a complex life product," says Oregon's Ario, "there aren't really any local conditions that ought to change how the product is reviewed."

Besides, the way Americans move around, most insurance consumers will find themselves living in several jurisdictions during the course of their lives.

"So if the Oregon regulator thinks the Oregon system is the best in the world, it still isn't really functional because half the people in Oregon who currently hold one of those life products likely bought it in another state anyway," Ario added. "Jurisdictions are no longer isolated like that.

"Think about long-term care. If somebody buys their long-term care product in Louisiana today, 20 years from now they're up here and we're trying to interpret what that policy means and how to apply the Oregon delivery system to the language of that policy."

Short-term, perhaps Hunter and other consumer advocates are right in worrying about how speed-to-market initiatives, such as greater file-and-use, will be implemented. In the long run, though, it appears that the public will be served best by a regulatory system with the flexibility to keep up with changing needs.

"There's a significant advantage to the consumer in moving toward a more uniform system," Ario said.

"But I think you have to break it down product by product," he added. "In some cases — certain types of property and casualty products — there are going to be very good reasons different states are going to want to have different types of protections for consumers. The homeowners cancellation rules are going to look different in southern Florida than they are somewhere else, for instance."

Health products, too, often are pegged to specific markets. Indeed, except for most life products and commercial lines products, the original concept — local regulators know what's best for consumers in their local markets — remains valid.

At the same time, however, some products lend themselves to serious levels of coordination. As long as speed-to-market concentrates on those areas, it's hard to do anything but wish speed-to-market godspeed. Especially since cooperation doesn't for a moment have to mean ripping apart the state-by-state system.

"Think about 50 state actuaries all looking at the same product," said Ario, "all reinventing the wheel in terms of their analysis.

"Wouldn't it be better if we had some mechanism to pool those 50 actuaries so they could come together, work together to agree on what are the best standards and then try to promulgate those standards out in all the states and then come to some kind of joint resolution?

"If I was one of those actuaries, I think I would feel a little frustrated at the way every state reinvents the wheel. I'm not saying there's no way you can talk to each other in the current system. People can get together at the NAIC and they can call each other on the phone. But it would be much better, I think, if there was an organized way in which those people were pooled up and we got the synergy of their combined resources rather than the isolation of the current system."

The current system certainly includes individual states' isolated efforts to speed approval of new products. But pooled efforts can have an even greater impact.

Can't there be too much speed-to-market, though?

"If the only emphasis is speed, then yes, there could be problems for the consumer," said Ario.

"But I would argue that a coordinated process is better for both the industry and the consumer. It's more predictable for both of them, it's more accountable for both of them, and both of them have an interest in having better expertise, coordinated expertise.

"So I think if it's done right, it's a win-win for the industry and for consumers."

If anything is pushing speed-to-market today, it's probably technology more than GLBA.

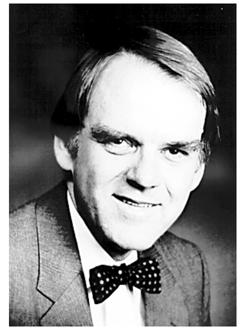
"This would have been very difficult to do 10-20 years ago because you would have been trying to figure out how to fly all these people to the same place so they could sit at a table and work together," said Ario.

"Now the filings will be done electronically. And folks from different states can sit at their own computers, in their own states, and communicate instantaneously with one another — and do that same kind of collaborative process without having to leave their own desks.

Speed-to-market, says Oregon's Ario, "has tremendous opportunities not just for the companies, but also for the consumers — and for us as regulators to do our job better." ■

Five Reasons Why Insurance Consumers are Concerned About Speed-to-Market

By J. Robert Hunter
Director of Insurance for the
Consumer Federation of America



1. No Hurry: Consumers, who have been victims of life insurance policies that promised rates of return they could not give, consumer credit insurance policies that pay pennies in claims per dollar in premium, and race-based pricing, are in no hurry for such policies.

2. Consumer Protections Weakened: Urgently needed, particularly in the era of globalization and Internet sales, are standards to ensure fair pricing, adequate disclosure and a more honest marketplace, which should be part of any faster approval processes. We are concerned that the NAIC plans sacrifice, rather than enhance, consumer protections.

3. CARFRA Concerns: The Coordinated Advertising, Rate, and Form Review Authority (CARFRA), a voluntary organization, is dangerous for consumers. CARFRA lacks direct accountability to the relevant public. There is no assurance that standards for product approval will benefit consumers. For example, if a panel made up of Montana members approves a rate or policy for use in California, then it will be difficult for California consumers to object. CARFRA must be an independent, legally authorized entity with democratic processes such as on-the-record voting, notice and comment rulemaking, conflict of interest standards, prohibitions on ex-parte communications, etc. CARFRA cannot rely on the industry it regulates to provide its funding.

4. The Deregulation Threat: Deregulation, which is on the horizon, poses a huge threat to consumers. In a bow to industry pressure, the NAIC is considering "deregulation," which means doing away with approving policies and rates before the policies are sold and relying on market conduct regulation to identify and address abuses. We believe the entire premise behind deregulation (less front-end regulation) coupled with more back-end regulation (market conduct) is deeply flawed.

5. Smarter, Not Less Regulation: In the absence of rate regulation, consumers could face huge and immediate price increases in their auto insurance and have little or no choice, especially if the large insurers all move to increase rates. Based on the regulators poor track record of market conduct regulation (*e.g.,* life insurance massive market abuses), it is clear that consumers need better and smarter regulation, not less regulation. ■

Planning Ahead

- April 8-10, 2001 — Market Conduct School for industry, sponsored by IRES Foundation. Westin Harbor Resort, Savannah, Ga.
- 2001 — IRES CDS. Baltimore. July 29 - 31 Hyatt Regency Inner Harbor
- 2002 – IRES CDS. San Antonio. July 28-30 Hyatt Regency
- 2003 — IRES CDS. Scottsdale, Ariz. Hyatt Gainey Ranch

Five strengths of Speed-to-Market

By George Nichols III
President, National Association of Insurance Commissioners

The National Association of Insurance Commissioners made history on March 13 of this year when commissioners unanimously adopted the *Statement of Intent: The Future of Insurance Regulation.* The agreement created a blueprint for substantial regulatory reforms exceeding the goals set by Congress with its adoption of the Gramm-Leach-Bliley Financial Services Modernization Act.

We believe state regulators are the closest, most responsive and most effective representatives of consumers. But we also recognize a changing and competitive marketplace where we need to balance national uniformity with state-based solutions.

I want to recognize Michigan Insurance Commissioner Frank Fitzgerald and Pennsylvania Commissioner Diane Koken who co-chair the NAIC Speed to Market Working Group. Working together, these commissioners have identified the following key strengths of Speed-to-Market proposals:

1. Uniformity: The goal is one-stop filing for products issued on a multi-state basis, where appropriate. Flexibility still is possible to allow local treatment of conditions produced by local markets. In other words, we can balance national standards and uniformity with state-based solutions. The Coordinated Advertising, Rate and Form Review Authority (CARFRA) will allow regulators to review and approve rates, forms and advertising filings. Regulators will continue carefully reviewing and evaluating products, but approval will come with coordinated, expedited action.

2. Efficiency: Traditional product approval was not always reviewed in a timely manner. The vision is for an acceptable balance between timely review and adequate consumer safeguards. Electronic filings can link this multi-state coordination. A centralized electronic database will show everyone the product and the price, greatly enhancing comparison-shopping and the consumer assistance that states can give to the public.

3. Innovation: The days of slow-moving bureaucracies are over. We need new ways to encourage new products that provide consumers with choices and greater benefits. More importantly, in a global market, we need to allow the insurance industry to compete with all other kinds of financial services and investments.

4. Unified market conduct approach: Our vision for the future is to use more zone or multi-state examinations. We should get away from doing comprehensive reviews every three to five years and, instead, focus on targeted examinations on a more frequent basis, while using the examination process and self-auditing results from insurers. In order to provide optimal protection to consumers, the 50 states must create a uniform, national approach to market conduct. The best state regulation of the future will embrace uniformity of rules and standards and adhere to them. The states need to coordinate so that we are addressing the needs of every consumer in every state where the insurer is marketing. By doing so, the consumer is afforded protection in all jurisdictions.

5. Continue to regulate business of insurance: We must remember that the most important daily business of state regulators is devoted to handling consumer calls and complaints. But a single consumer call on any given day can trigger immediate fraud or consumer investigations if business practices are unfairly harming the consumer. The states have 10,000 employees responding to 4 million complaints a year and remain the closest and most responsive to consumers. There is nothing about "speed-to-market" that will impede these daily responsibilities and, in fact, speed-to-market will enhance better disclosures, uniformity and comparison-shopping. ■

Communicating Effectively With Consumers

ESCHEW OBFUSCATION

By Paul J. Bicica
Chair, IRES Consumer Services Section

We sometimes forget that consumers have lives outside of insurance. They buy insurance, pay premiums and never think about insurance again until a problem arises. As regulators we know the jargon, the processes, the glitches. Consumers don't. They look to us to resolve the problems and provide an explanation of what happened – in language and style they can understand. Consumers aren't dumb. They just don't live insurance like we do. We can serve them so much better if we ensure our letters to them give complete information in a readily understandable manner.

Insurance Jargon. We talk insurance all day long. Terms such as completed operations, insurable interest and conversion rights are second nature to us. To a typical consumer an endorsement is the signing of a check, a form is something to be filled out. We have to take special care to limit these terms in our letters to consumers. If technical terms must be used for accuracy, a short explanation should be included. If your letter is a cover letter transmitting a company response, review the company response and provide any necessary clarification.

Keep It Simple. We're here to help consumers, not impress them with our vocabularies. We've all read letters from people who use every chance to replace a perfectly good common word with a more esoteric one. *Read* becomes *peruse, cause* becomes *effectuate, prevent* becomes *interdict.* The same holds for phrases. *Until* becomes *until such time as, now* becomes *at this point in time,* and *after* becomes *subsequent to the time that.* Consumers need information in uncluttered language that can be understood by anyone with a basic education and literacy level.

Active, Active, Active. "Your claim file has been subjected to a regulatory review analysis by me." Huh? "Your salvage vehicle can be retained by you." Huh? again. Compare these with "I reviewed your claim file," or "You can keep your salvage vehicle." The active voice, rather than the passive, leaves little room for misinterpretation.

One Idea at a Time. The best way to befuddle a consumer who has received your letter after a hard day at work and is sitting trying to decipher it at the kitchen table is with a sentence that has more than one idea, which always leads them to wonder what part of their premiums will be returned and what is this factoring in of the cost of insurance and annuities were simpler a long time ago and they were promised a return of 14% in 1986 but now everyone denies it and they lost the paper the agent gave them and now it's a question of fact about what was said but they can reinvest in one of three offers or rescind and there's that cost of insurance thing again. One idea to a sentence. Use periods instead of commas. Allow the consumer to separate and consider each idea.

Paul Bicica

Long Paragraphs are Overwhelming. A consumer confronted with a letter that has long narrative paragraphs will freeze up just at the appearance. "I can't understand all *that!*" As with sentences, limit paragraphs to one main idea. You may want to use a bullet format if presenting complex issues. "The Insurance Company has agreed to pay your claim based on 1…, 2…, 3…."

Just the Facts, Ma'am. You're responding to a complaint about refusal to pay replacement value for a damaged roof. Don't clutter your letter with a discussion of jewelry endorsements or umbrella insurance. The consumer will assume that, because you've included it, the information must be relevant to their roof issue. Focus on the issue. Enclose separate consumer guides if you want to provide additional information.

Please Fill This Out. We often have to write consumers to obtain information or ask that they take an action. Consumers want to do whatever is necessary – they just don't always understand the forms or processes. A deadline or time frame should always be given.

"The enclosed materials should be completed and signed by you and sent back as soon as possible." Complete what? Sign where? Sent back where? When? Compare this with "Please complete lines 6 through 10 of the enclosed blue form, sign on line 11 and return to me within 10 days of the date of this letter." You'll be far more likely to obtain the information you need when you need it.

Our job as regulators is to ensure that consumers have as much understanding of and as little trouble with insurance as possible. Simple, clear, concise letters written with the consumer audience in mind will facilitate that. ■

Mr. Bicica is Consumer Services Chief for the Vermont Department of Banking, Insurance, Securities and Health Care Administration.

Quo Vadis, Market Conduct?

It seems these days everyone is looking into the market conduct operations of state insurance departments. As the debate rages over whether the federal government could do a better job than states in protecting insurance consumers, the recent focus on market conduct regulation may very well play a pivotal role in shaping the future of insurance regulation. On these pages we summarize some of the findings and conclusions of two recent market conduct reports, the National Conference of Insurance Legislators report and a trade association study.

❖ The NCOIL Survey

This past summer, the Insurance Legislators Foundation of the National Conference of Insurance Legislators (NCOIL) published its own study of insurance market conduct examination in the United States. The study was done for NCOIL by PricewaterhouseCoopers LLP.

The report costs $75 per copy. You can place an order by phone at (518) 449-4698, or email at mackinco@albany.net.

Some excerpts from the NCOIL report:

√ The basic issue is the purpose and relative emphasis of market conduct examinations. Should the primary emphasis be on detecting and correcting illegal or unfair business practices, or should examinations also look for and correct inadvertent errors in insurers' transactions? Some insurers express the concern that some state insurance departments place too much emphasis on inadvertent errors.

√ The NAIC's current Market Conduct Handbook states the philosophy of market conduct surveillance this way:

> The market conduct examination can be most effective if it focuses on general business patterns or practices of an examinee. While not ignoring random errors, the market conduct examinations should concentrate on an insurer's general practices.

continued on next page

◆ The Industry Viewpoint

In late August, a coalition of the major insurance company trade associations released a joint statement regarding the state of market conduct regulation by the states. The statement outlined a 12-point program to improve the market conduct examination process. The states have, according to the trade associations, the requisite statutory authority to implement these suggestions *immediately*. In addition, the proposals, they said, "will make market conduct examination procedures more efficient without jeopardizing any protections afforded by market conduct examinations to the consumer."

The associations were the Alliance of American Insurers, the American Insurance Association, the National Association of Independent Insurers and the National Association of Mutual Insurance Companies.

Following are some excerpts from the associations' statement:

√ The overriding goal of market conduct examination should remain as stated in the [NAIC] Market Conduct Examiners Handbook: "The market conduct examination can be most effective if it focuses on general business patterns or practices of an examinee. While not ignoring random errors, the market conduct examination should concentrate on an insurer's general practices." Examinations that focus on

continued on next page

The NCOIL Survey

Approximately 18 percent and 15 percent of the Chief Examiners (CEs) and Examiners-In-Charge (EICs) surveyed disagreed with this statement. Approximately 25 percent of the insurers believed that the state insurance department did not conduct the subject market conduct examination in a manner consistent with this statement.

√ The survey indicates that 13 states utilize contract examiners — either individuals or firms— to perform market conduct exams. The number of contract examiners utilized varied. The average number of contract examiners used was four per state, but one Chief Examiner reported using 44 contract examiners. Also, one third of the Chief Examiners reported an increase in the number of contract examiners used.

√ The use of contract market conduct examiners has evoked some controversy, as it did with financial examiners many years ago. In some cases, contract examiners are viewed as a threat by staff examiners. One question that has surfaced is whether contract examiners should be used for routine, comprehensive examinations or only targeted examinations when staff examiners are not available.

√ The survey responses provided interesting results concerning the qualifications of market conduct examiners. Five percent of the states responding to the survey do not use the staff classifications listed in the NAIC Handbook. It also appears that a significant number of the staff market conduct examiners do not meet the qualifications outlined in the NAIC Handbook.

√ Chief Examiners indicated that internal complaint analysis was the most frequent trigger for performing a market conduct examination. Approximately 80 percent of the Chief Examiners indicated that either they or the Commissioner were the primary decision maker in determining which insurers undergo a

continued on next page

> **"About 19% of the insurers believe that the time frame for responding to insurance department requests is too restrictive, whereas none of the Examiners-in-Charge believe that the time frames are unreasonable."**

The Industry Viewpoint

single inadvertent errors do little to further consumer protection and do not maximize the use of market conduct resources of the Insurance Department.

√ States should strive for greater coordination in scheduling and conducting market conduct examinations of insurers. Members of all four trade associations oppose applying the multi-state examination concept to property and casualty insurers. There are simply too many variations in the market conduct standards from state to state in the property and casualty area to make the multi-state examination process feasible at this time.

√ Departments should rely more fully on targeted market conduct examinations rather than comprehensive examinations. Departments would be better served directing resources to "problem" companies in the market conduct examination area.

√ Departments need to exercise greater oversight and control of examination costs. Tools that should be utilized in this area include (a) sharing and discussing with the insurer prior to the market conduct examination the Department's time budget and work plan for the examination; (b) sharing budget projections with the insurer and developing compensation standards when the Department utilizes contract examiners; and (c) developing a peer review system or other appeals process for review of examination billings when there is a dispute between the insurance company and the Department over a billing.

√ The NAIC should develop and the Departments should follow uniform standards for requesting data from insurance companies during market conduct

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Quo Vadis, Market Conduct?

continued from previous page

targeted market conduct examination.

√ Insurers believe there is a significant amount of duplication of effort and overlap by the state insurance departments performing market conduct exams. Furthermore, insurers believe that state coordination efforts to avoid duplication of efforts is less than adequate.

√ 25 percent of the insurance departments surveyed use "testing" methods that involve department staff or others who pose as consumers to assess insurers' market practices. This is an alternative means to detect market conduct violations that appears to be used more extensively than previously anticipated.

√ The Chief Examiners indicated that they almost always prepare a work plan and budget. However, they indicated that they do not always share the work plan and time budget with the insurers. Furthermore, approximately 29 percent and 27 percent of the Chief Examiners and Examiners-In-Charge, respectively, indicated they never share the work plan and time budget with the insurers. 42 percent indicated that the work plan was not shared with them.

√ 19 percent of the insurers believe that the time frame for responding to state insurance department requests is too restrictive, whereas none of the Chief Examiners and Examiners-In-Charge believe that the time frames of their requests are unreasonable.

√ The scope of examinations has been a particularly significant issue, at least with insurers. Insurers have expressed a concern that the scope of some examinations is too broad and ventures into areas that do not require or are not suitable for regulatory review.

√ More than 60 percent of the Chief Examiners indicate that insurers self-assessment activities such as internal audit and compliance reviews by outside experts would not influence the scope of their market conduct examination, and more than 75 percent of the Chief Examiners indicated that an Insurance Marketplace Standards Association (IMSA) certification would not influence the scope of their market conduct examination. ■

examinations.

√ Final examination report changes are needed. Insurance companies should be given the opportunity to include within the final examination report a discussion of any disagreements that the company has with the findings and the company's reasons for those disagreements. This will allow subsequent examiners within the same department or examiners in other states to be aware of the insurer's disagreements and reasons for the disagreements.

√ There must be a rational basis for assessing administrative penalties and establishing the size of these penalties. The penalty structure should also allow the insurance company to take remedial action to correct any violations uncovered in a market conduct examination.

√ The NAIC and states should continue to adopt minimum training standards for market conduct examiners. This may include requiring designations under the Accredited Insurance Examiner or Certified Insurance Examiner programs for specified market conduct examiners. Training programs on the Market Conduct Examiners Handbook and the proper purpose of market conduct examinations should be encouraged. Both the regulatory and insurance communities must fully support the efforts of the Insurance Regulatory Examiners Society.

√ Insurance companies must be given sufficient time in which to come into compliance with new or amended statutes and regulations that require changes in company operation. Too often the statutes or regulations require compliance within an unreasonably short timeframe, particularly when they require system changes for insurance companies.

For a copy of the joint industry statement, call Lenore Marema, Alliance of American Insurers, 630-724-2143. ■

GAO's Frankel Report: States Failed to Notice Obvious Signs of Fraud

On Sept. 19, the Congress's General Accounting Office released a report attributing the insurance scam perpetrated by Connecticut financier Martin Frankel to inadequate oversight by state insurance regulators. The report concludes that inadequate policies and procedures as well as the failure of regulators within and outside the insurance industry to share information allowed Frankel to continue fraudulent activities for years before he fled the U.S. in October 1999. Frankel, who is believed to have stolen more than $200 million from several insurers, is currently serving a three-year prison term in Germany for smuggling diamonds and traveling on false passports. Frankel is seeking to avoid extradition to the U.S., where he faces 36 federal counts of fraud, money laundering, racketeering and conspiracy in addition to civil litigation filed by five states.

The following are excerpts from the GAO report:

Insurance companies in several states lost in excess of $200 million through this investment scam. A fundamental aspect of the scam was the concealment of a secret affiliation alleged to exist between entities in the insurance and securities industries, in which the interests behind the ownership of the insurers as well as the investment entity controlling the insurers' assets were one and the same. The role of Mr. Frankel and others is presently the subject of a federal criminal investigation as well as other state criminal and civil actions. Taxpayers will ultimately bear much of the losses resulting from the scandal, together with policyholders who are not fully covered by their own states' insurance guaranty programs.

* * * *

Insurance regulators were not prepared to prevent or detect a scam allegedly perpetrated among several insurers for nearly eight years by a rogue broker who had migrated into the insurance industry. Although routine regulatory monitoring and examination activities are not designed to proactively look for fraud, there is a regulatory responsibility to be alert for fraud.

Additional mechanisms should be in place that are designed to detect possible fraud—so called "red flags" that trigger additional regulatory scrutiny. In the scam allegedly carried out by Mr. Frankel, these red flags included peculiarities with the trust, inconsistencies in regulatory data related to asset custody and control, and the unusual investment activities being reported by insurers.

Given these unusual activities and circumstances, even though they were not specifically contrary to law or regulation, insurance regulators could have reacted to the warning signals by judiciously asking additional questions. In a number of circumstances, those questions could have unraveled the scam. Clearly, in this particular case, there was a lack of professional skepticism.

* * * *

In addition, long-standing information-sharing issues among federal and state financial services regulators further exacerbated the negative impacts of the scam. Insurance regulators had insufficient means for conducting background checks and measures to safeguard and verify the insurers' invested assets. In addition, state insurance regulators apparently did not have or seek sufficient expertise in the area of securities and investments to adequately scrutinize the unusual investment activities being reported to them by the Frankel-managed insurers.

Similarly, the most significant information-sharing weakness observed was the inability or failure of insurance regulators to access regulatory information available from the securities industry.

At each phase in the oversight process, insurance regulators would have benefited from information available through local state securities regulators to further validate the business transactions between the insurance companies and other individuals and entities. Accessing this information was neither suggested nor required, either by the policies and procedures of insurance departments or of NAIC.

*   *   *   *

Once regulatory concerns finally surfaced, the lack of information sharing among state insurance regulators allowed the scam to spread to other states.

*   *   *   *

At nearly every stage of the scam, regulators could have exposed the fraud sooner and limited the damage if there had been better and more consistent sharing of regulatory information. Information sharing failures existed between state insurance departments and other state and federal regulators, including state securities departments, as well as among state insurance departments in different states.

*   *   *   *

When questions concerning an insurer's investment activities did arise, insurance regulators did not generally seek regulatory data or expertise from regulators in the securities industry.

Moreover, the movement of undesirables from one industry to another would be more easily controlled with better sharing of disciplinary information. Overall, as illustrated by the Frankel case, each of the financial regulators needs to consider regulatory data from other financial sectors to properly oversee the business relationships and transactions between institutions in different financial sectors.

*   *   *   *

Finally, we recognize the efforts of NAIC and the states in proposing corrective actions. These actions represent an acknowledgment that the weaknesses exposed by this scam need to be corrected. As these corrective actions are implemented, the potential for a similar scam to be successful should be substantially reduced. ■

“. . . At nearly every stage of the scam, regulators could have exposed the fraud sooner and limited the damage if there had been better and more consistent sharing of regulatory information. Information sharing failures existed between state insurance departments and other state and federal regulators, including state securities departments, as well as among state insurance departments in different states . . .”

— GAO report on the Martin Frankel insurance fraud scandal

You can view GAO documents on the Internet at http://www.gao.gov. The Frankel report, “Scandal Highlights Need for States to Strengthen Regulatory Oversight,” is GAO document # GGD-00-198. To find the Frankel report, go to the GAO home page, click on “GAO Reports” and then click on “Search GAO Archives.”

What really happened to Progressive?

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Editor's Note: *For a while it looked like Progressive Insurance Company was hitting on all cylinders in the private passenger auto insurance market. Its creative underwriting strategies, commitment to high-risk underwriting and unique online quoting service were the talk of the industry. What happened? We turned to Brian Sullivan, the tireless editor of "Auto Insurance Report," to find out.*

growth and profit. To avoid these growing pains, the company could have simply avoided growing, or grown much more slowly. But if you reach for the summit as Progressive is wont to do, there are times when you have to sit down and rest. The rate increases, staff reductions and impending lost market share are sound decisions of an organization that isn't happy with the status quo, and fully intends to resume its climb to the top.

That isn't to say it won't be painful. It will be. But the pain is necessary.

Looking at Progressive's personal auto performance in 1999, one might wonder what all the fuss is about. The national market grew by less than 1%. Progressive grew by 16%, even better than its 14.7% growth in 1998. Best of all, this growth came in many new states, allowing the company to spread its geographic mix of business and reduce its reliance on its top three markets.

But there are indeed signs of trouble. First is that even at 16%, Progressive's growth rate has slipped markedly from the salad days of 1997, when the (admittedly smaller) company grew a whopping 32.2%.

More important is the change in the loss ratio. It isn't often that a large company's personal auto pure loss ratio jumps seven points in a single year, but that's the trick Progressive pulled off when the loss ratio rose from 56.1% to 63.0%. Yes, that is still below the national loss ratio of 65.6%, but the trend was a sign of things to come.

The 2000 Results

The company's results have deteriorated even more sharply in 2000, and it looks like the 1999 loss reserve was not enough to cover claims for the first time in many years.

Two states are perfect examples. In New York, Progressive posted a 69.7% loss ratio in 1999, which isn't great, but not exactly horrible. Well, just halfway through 2000 the company's losses were swelling so dramatically that Progressive was compelled to announce it would stop selling coverage to new customers on Long Island, in New York City and in Westchester County until the state insurance department approved rate hikes. Such brinkmanship only comes when there is really big trouble on the bottom line. In California the company posted a wonderful 57.6% loss ratio in 1999. But in 2000 Progressive is

Brian Sullivan is editor of *Auto Insurance Report,* a weekly newsletter in which this article first appeared.

getting hammered on the claims side, and results are forcing the company to revamp its strategic plan to slow growth in an effort to return to profitability.

Progressive's New Plan

What is the new plan? Progressive would hate the description, but it seems safe to say that Progressive is now poised to "shrink to profitability." In the second quarter alone Progressive implemented rate increases in 22 states for an overall impact of 3.8% in the quarter and 6.8% year-to-date. We lack data, but it seems the advertising budget has been cut. New business sales are no longer the main focus. Renewing good customers, and nonrenewing bad customers, is the new focus.

Why did the company's fortunes spin out of control so quickly? Some of the woes are external. Claims costs are rising for everyone, driven by higher medical costs, higher auto parts costs as non-OEM parts are taken out of the mix, an unexplained increase in frequency for many carriers, and an increase in severity that some are attributing to the huge number of heavy trucks and SUVs replacing smaller sedans on the roads today.

It was unfortunate for Progressive that these external factors turned up the heat just as internal issues started to evolve. Consider:

- You can't have double-digit growth for a decade, sometimes 30% in a single year, and not take on some bad risks.
- You can't expand from a historic base of nonstandard auto into standard and preferred without tripping.
- You can't be a pioneer in Internet marketing (Progressive has an award-winning Web site) and a big player in direct response marketing via mail and telephone without spending, and sometimes wasting, big bucks.
- You can't utilize direct response — outside of your traditional agent distribution channel — and not make underwriting

continued on next page

Autograph Technology Allows Insurers to Accurately Track Usage

Progressive's creative spirit remains alive and well as evidenced by its recent announcement that its subsidiary, Progressive Casualty Insurance Company, has been awarded a patent for *Autograph*, its usage-based auto insurance rating system. Robin Harbage, General Manager of Progressive, says that with *Autograph*, consumers gain control over their auto insurance costs because their premium is based largely on how much, when and where the vehicle is driven. For example, an insurer using *Autograph* would be able to tell if your car is actually driven in the territory you claim to have garaged the vehicle, what hours of the day you drive (contrary to popular belief, rush hour is not necessarily the most hazardous time to drive) and exactly how many hours a month you drive.

The system uses GPS (Global Positioning System) and cellular technology to gather and report these details to your insurer. This, in turn, produces a monthly auto insurance bill much like a utility bill. "It's very simple," says Harbage, "the less you drive, the less you pay."

The rating methodology uses broad rating territories to assess the risk posed by each driver. "We're not interested in whether you were at K-Mart at 11 p.m. on Tuesday," says Harbage, "but we do want to know the broad territories in which you drive and the general time periods during which you operate your vehicle so that rates can be determined accordingly." The system, which was successfully tested in Texas, resulted in premium savings averaging 25 percent for Houston consumers.

Thus far, few privacy concerns have emerged with GPS-based underwriting, but as the approach becomes more commonplace, its impact on insureds' personal privacy will surely attract scrutiny.

— W.C.

What really happened to Progressive?

continued from previous page

mistakes. Direct response underwriting and agency underwriting are worlds apart.

- You can't grow as fast as Progressive and not acquire some inadequate employees.
- You can't build computer systems that fast without making mistakes.
- You can't enter homeowners insurance for the first time without putting a drain on already over-taxed management. Just one more new headache.
- And very, very importantly, you can't build a brand new claims team in brand new states or territories and not expect it to under-perform both the experienced claims operations the company had in place, or the established claims organizations of competitors.

These internal issues are no one's fault. They happen to every company that grows. The trick is to recognize them before they threaten to pull the company down altogether, as they did at fellow non-standard specialist Integon. Integon is a wonderful company, now part of GMAC, that was once the darling of Wall Street and a best-practices model for many competitors. But the company grew too quickly, and too broadly in a geographic sense, to operate successfully with its centralized management concepts. A capital crunch forced the sale of the company, though the quality of the core business prevented fire-sale pricing.

Progressive is apparently avoiding this fate by starting out with a better organization, and then recognizing the trouble signs sooner in the process.

What does the future hold?

First and foremost, accept that 2000 will be a crummy year. With half the year already on the books, results are not just disappointing, they're terrible. The third and fourth quarters might be a little better, but not by much. There might even be another upward adjustment to loss reserves.

Progressive is hopeful for growth in 2001, praying that the hard work of this year will turn into profits and growth next year. We're less confident. All the pricing will take six months to a year to pass through the system. All the staff changes will prevent real forward momentum for at least six months. The expanded claims operation won't mature overnight - give them another full year to get established.

No, Progressive's future isn't today, or even tomorrow. But, barring some unforeseen catastrophe, in 2002 you will see an organization that has taken the tough pricing decisions, cleaned up its book of business by nonrenewing the money-losing risks, created a better balance between new and renewal customers (regrettably, by having fewer new customers), stabilized its computer systems, and matured its claims operation.

Only with this work complete will the company be ready to take on its three major challenges:

1) Restart its growth engine,

2) Establish a strong brand identity,

3) Prepare for the day when chairman and company leader Peter Lewis decides to call it quits. ■

Insurance Quote of the Month

"... insurance — that's a Washington term."

— George W. Bush, during the third presidential debate

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REGULATORY ROUNDUP

By
Stroock & Stroock
& Lavan LLP

OHIO – Department of Insurance reaches settlement over the alleged use of unlicensed agents

The Ohio Department of Insurance entered into a Consent Order in August with four affiliated property/casualty companies in connection with an investigation of the companies' agent licensing practices. In the consent order, the companies admitted to using unlicensed employees to quote insurance premiums and discuss insurance coverages in violation of Section 3905.01 of the Ohio Revised Code. Section 3905.01 prohibits any unlicensed person from procuring an application of insurance, quoting premiums, discussing coverages, or soliciting, negotiating, or effecting a policy of insurance in the state. Pursuant to the Consent Order, the companies will pay a fine and have agreed to use only licensed Ohio agents to handle any telephone calls from any applicant who is an Ohio resident. For more information, email Ken Brown at ken.brown@ins.state.oh.us.

It is worth noting that the Section 3905.01 "employee" licensing exemptions are more specific than those that are available under the Producer Licensing Model Act recently adopted by the NAIC. Section 4(B)(8) of the Model Act provides that employees of an insurer or insurance producer need not be licensed to "respond to requests from existing policyholders on existing policies provided that those employees are not directly compensated based on the volume of premiums that may result from these services and provided those employees do not otherwise sell, solicit or negotiate insurance."

CALIFORNIA – Governor signs law expanding the scope of the agent/broker licensing requirement

In September, Governor Gray Davis signed into law Assembly Bill 393, which amends existing state law governing production agencies. The Bill has generated particular controversy over its amendment of Section 1635 of the Insurance Code, because it will apparently require insurance call-center employees, who make changes to existing policies, such as adding a driver or car to an auto policy, to be licensed as agents. Section 1635, as presently written, exempts certain individuals from the agent/broker licensing requirement, including employees of an insurer at its home or branch office who do not engage in the solicitation or negotiation of insurance. Assembly Bill 393 narrows the Section 1635 exemption to further require all exempt employees to refrain from "effecting contracts of insurance." The Bill's licensing exemption is narrower in this regard than the recently adopted NAIC Producer Licensing Model Act. Assembly Bill 393 also establishes a new personal lines broker-agent license requirement for persons transacting automobile insurance, residential property insurance, personal watercraft insurance, and umbrella or excess liability insurance involving one or more underlying automobile or residential property insurance policies. The legislation also creates a new article in the Insurance Code governing credit insurance agents. Assembly Bill 393 will become effective on January 1, 2002. To view the bill, visit www.leginfo.ca.gov.

NEW YORK – Insurance Department introduces new "Speed-to-Market" policy filing procedures

In August, the New York Insurance Department introduced new streamlined speed-to-market procedures for filing life, property and health insurance policies. Policies submitted under the speed-to-market procedures must be accompanied by a certification of compliance, a product checklist and a filing checklist. The Department's new product checklists identify required and optional provisions and require the insurer to identify the location in the policy form of the compliant language. The certification of compliance must be signed by an authorized officer of the insurer and confirm that the policy complies with the product checklist and all applicable laws and regulations. The Department expects the new procedures to reduce staff resources dedicated to preliminary review of product filings, thereby increasing the resources dedicated to market conduct examinations and the implementation of Gramm-Leach-Bliley Act-related policies. The speed-to-market filing procedures are optional and do not replace existing filing procedures. For more information, visit www.ins.state.ny.us/p0008212.htm. (**Editor's Note:** *See Speed-to-Market story, p. 1)*

LOUISIANA – Workers' compensation funding formula constitutes a regulatory taking as applied to plaintiffs

The United States Court of Appeals, Fifth Circuit, held on September 15, 2000 that a Louisiana statute that altered the funding formula for the Louisiana Workers' Compensation

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The New York-based Stroock & Stroock & Lavan LLP Insurance Regulatory/Corporate Practice Group includes Donald D. Gabay, Martin Minkowitz, William D. Latza, and Vincent Laurenzano, an insurance finance consultant. They gratefully acknowledge the assistance of Todd Zornik, law clerk. This column is intended for informational purposes only and does not constitute legal advice.

Second Injury Fund ("SIF") was unconstitutional as applied to the plaintiff insurers. In 1995, the Louisiana legislature enacted Act 188, which changed the method of calculating insurers' annual contributions to the SIF from a percentage of premiums collected to a percentage of workers' compensation benefits paid by the insurer in the previous calendar year and retroactively applied to insurance policies written prior to the passage of the Act. Moreover, the Act applied to workers' compensation insurers who, like the plaintiffs in this case, had withdrawn from the Louisiana market or substantially reduced their underwriting in the state prior to the Act's passage. While insurers that are still writing business in the state are able to pass on to their insureds the costs of the SIF assessment, the plaintiff insurers had exited the market and were therefore unable to recoup the charge. The court held that the costs to the plaintiffs under Act 188 represent a substantial liability and therefore constitute a regulatory taking in violation of the Takings Clause in the Fifth Amendment of the United States Constitution. See *United States Fidelity & Guar. Co. v. McKeithen*, 2000 WL 1229014.

NORTH DAKOTA – Department of Insurance issues bulletin providing guidance on the proper administration of Retained Asset Accounts

In August, the North Dakota Department of Insurance issued Bulletin 2000-3, which sets forth procedures that insurers must follow when distributing life insurance proceeds through retained asset accounts ("RAA"). An RAA is an account into which an insurer deposits life insurance proceeds while the beneficiary decides how to spend the funds. Among other requirements, the insurer must disclose to the beneficiary whether the RAA is a checking or draft account and explain the account's features. If the insurer offers a checkbook option, it must clearly disclose that payment of the total proceeds is complete once the proceeds are deposited into the RAA and the beneficiary receives a checkbook. If the beneficiary statement form offers a lump sum payment and the company uses RAAs, the form must offer the claimant the option to receive payment of the proceeds either directly by check or indirectly by depositing the proceeds into an RAA. The Department of Insurance will apply the guidelines set forth in Bulletin 2000-3 when conducting market conduct examinations and reviewing consumer complaints. To review Bulletin 2000-3, visit www.state.nd.us/ndins/deptpubs.

CONNECTICUT – Insurance Department offers guidance to insurers complying with Public Act 99-284 regarding the prompt payment of accident and health claims The Connecticut Insurance Department issued Bulletin HC-56 in August to provide guidance on the meaning of a "claim" under recently revised Section 38a-816(15) of the Connecticut General Statutes. Section 38a-816(15), in part, requires an insurer to pay interest on a claim filed by a health care provider where the claim contains all necessary information and is not paid within 45 days of receipt. Bulletin HC-56 is intended to define the minimum criteria for the acceptance of a claim. Toward this end, the Bulletin provides a list of required minimum information for claims submitted on HCFA Forms 1500 and UB-92. It is important to note, however, that the Bulletin's criteria does not guarantee payment of a claim. The Bulletin emphasizes that the best way to ensure prompt payment is to file a fully completed claim consistent with an insurer's practices and procedures. To view the Bulletin, visit www.state.ct.us/cid/bullhc56.htm.

CALIFORNIA – Legislature passes bill governing the disclosure of information relating to insurer market conduct examinations

Senate Bill 1805, which governs the disclosure of information pertaining to market conduct examinations, awaits signature by Governor Gray Davis. Senate Bill 1805 requires the Insurance Commissioner to transmit to the State Auditor the entire file pertaining to any examination involving claims practices where such examination has been terminated or suspended. The State Auditor must review such examination to verify that it was properly terminated or suspended by the Insurance Commissioner. Senate Bill 1805 also requires the Insurance Department to publish on its website all fully executed stipulations, orders, decisions, settlements or other forms of agreement resolving market conduct examinations pertaining to unfair or deceptive practices. In addition, the Bill requires publication on the Department's website of every adopted report of an examination of unfair or deceptive practices. The legislation does not require, however, the disclosure of company documents obtained during an examination or any preliminary report of an examination. To view Senate Bill 1805, visit www.leginfo.ca.gov.

NEW YORK – Governor signs legislation amending life insurer stock dividend notice requirements

2000 N.Y. Laws Chapter 442 amends Insurance Law Section 4207(a) to permit any domestic stock life insurance company to distribute a dividend to its shareholders without prior notice to the Department, provided the aggregate amount of any dividend distributed in any calendar year does not exceed the lesser of: (1) 10% of policyholder surplus as of the immediately preceding calendar year; or (2) the company's net gain from operations for the immediately preceding calendar year, not including realized capital gains. Any company proposing a stock dividend in excess of this limit must provide notice to the Department of its intention to declare such dividend at least thirty days in advance of such proposed declaration. Chapter 442 became effective on September 20, 2000. To view Chapter 442, visit leginfo.state.ny.us:82/INDEX1.html.

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Who wins the race, and who loses in the Speed-to-Market? Cover story, p. 1

BULLETIN BOARD

√ IRES member Jorge A. Lozano recently received the Health Care Financing Administration Administrator's Achievement Award. The award was for leadership and commitment to improving consumer access to private health insurance. Lozano, AIE, FLMI, works in the Kansas City office of HCFA, enforcing provisions of the federal Health Insurance Portability and Accountability Act of 1996 in the state of Missouri.

In next month's REGULATOR:

√ Evaluating Total Losses: Who's doing it? How well are they doing it? Should they be doing it?

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THE REGULATOR is now online!

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