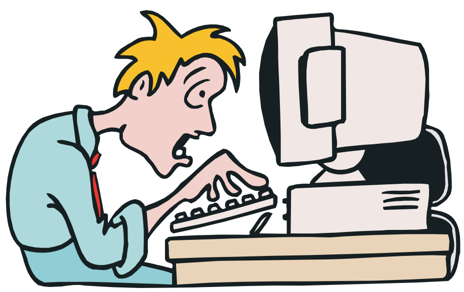
The Regulator®
INSURANCE REGULATORY EXAMINERS SOCIETY

Insurance on the Web: Humdrum sales never matched the hype

by Scott Hoober
Special to The Regulator

One of the concepts underlying the nation's love of the marketplace is that it's all the same. Selling apples or pears, selling Apples or Dells, selling insurance policies or time-shares — it's all the same under the skin.

After Sears, Roebuck invented the mail order catalog, everyone else was free to tag along and start up catalogs of their own. When the World Wide Web came along, it was just another kind of catalog: Who needs bricks when you've got clicks?



Who, indeed, even needed profits? Enthusiasm has always been enough, at least when it comes to Web-based businesses.

When the first dot.commer thought up the idea of selling insurance policies online, at the peak of the '90s boom, predictions ran wild. Agents and brokers are so yesterday! Online insurance will change everything!!

Infrastructure vs. attitudes

It hasn't of course.

Not that it's been like some of those too-optimistic online niches that optimistic investors thought they saw. Insurance, after all, is still being sold on the Web, and deserves to be. But the rosy growth predictions have gone out the window, largely because the Web has outgrown what Jamie Bisker of TowerGroup called "a self-serving myopia regarding human nature."

In a 2003 article on online insurance, Bisker said that technologists "tend to gloss over the human factors involved in the adoption of technology by a populace that does not always share the same world view."

As Internet shopping has matured, retailers, insurers and consumers all have adopted a more realistic set of expectations. Yet the basics of online selling, of insurance or anything else, is a moving target.

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Title insurance and California's reforms

by Bryant W. Henley and Kim Morimoto

Most of us recognize that title insurance is different from other personal lines insurance products.[1] But how do such differences affect a consumer's purchasing power? And, just as important, how do they affect a regulator's ability to protect consumers? The answer lies in the nature of title insurance, where real estate producers have an overabundance of influence and the consumer has little involvement in the selection or negotiation of the policy.

Most consumers are familiar with the purposes of automobile, homeowners' and health insurance. But few understand the need for title insurance — those that do represent a small minority of consumers.

Unlike consumers in a typical property and casualty transaction, title insurance consumers are usually afforded limited opportunities to select an insurer. Because of the nature of purchasing a home, a

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NOV 2006

The Regulator®

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THE REGULATOR is published every other month by the

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From the President

Bridges to Tomorrow: The Next 20 Years

As planning for the IRES Pittsburgh Career Development Seminar (August 12-14, 2007) gets underway, it struck me how appropriate it will be to celebrate IRES's 20th Birthday in the city of beautiful bridges (see photo). Located at the convergence of three rivers, downtown Pittsburgh proudly boasts one of the most beautiful skylines in the world. Accented with breathtaking views from its inclines and hills, Pittsburgh's resurgence seems to reflect a part of IRES history itself.

As any organization like IRES matures, founding members, established members, and new IRES prospects flow into one another as the Society ages. Like the Allegheny, Ohio, and Monongahela Rivers, IRES – at its 20th Birthday – will meet in Pittsburgh strong yet seeking to ride the proper current into the future.

For IRES to continue to grow, we must try new ideas and formats and use internal and external human and technological resources to better ourselves. By so doing, we can meet our top goals of increased membership, promotion of our Market Conduct Certification (MC+) Program, and innovative participation in our Career Development Seminars (CDS).

In order to achieve IRES' priorities, the winds of change must help build an even stronger structure for tomorrow. This includes reaching out and building bridges to other similar organizations such as the Association of Insurance

Compliance Professionals (AICP), the NAIC, the Society of Financial Examiners (SOFE), and the IRES Foundation. In the past few months, I have worked on building these bridges and plan on building other bridges in the near future with the Securities & Insurance Licensing Association (SILA), the Institute of Internal Auditors, and other groups.

In an age of e-mails, blackberries, and instant messaging, it seems that at times we forget that talking with one another in person is the most effective way to build bridges that are strong enough to weather any storm, bear any burden, and lead to a promising future.

As a blackberry user myself, I recognize the convenience of the device but am also conscious how many times I reply electronically to an e-mail rather than just picking up the telephone and having a true "on-line" conversation. I believe that in person - or at least via telephone - conversations strengthen understanding and relationships in the long run.

So, as volunteers continue to sign up for IRES committees and as IRES members gear up for the 2007 CDS, let us remember that the next generation of IRES members enjoy the luxury of our founding members' experience but also bear the responsibility of bringing the organization into a promising future. Let us work toward building those bridges, learning from our past, and growing toward tomorrow.

Please do your part to implement the winds of change by building bridges to tomorrow by reaching out and contacting existing and potential IRES members in person or by telephone today.

If I can help, please call me at 636-236-9642.

Thanks and take care,

Douglas A. Freeman, CIE
IRES President

2nd Annual Membership Drive

On July 20, 2006, the 2nd Annual Membership Drive came to an end. Congratulations to Chet Derk (PA), the winner of this year's drive. In addition to Mr. Derk's efforts in recruiting new members, the Membership & Benefits Committee would also like to thank the following individuals for meeting the Membership Challenge by recruiting at least one new member during the drive:

Tangela Ayo (LA)
Lyle Behrens (KS)
Linwood Bennett (VA)
Gary Boose (PA)
Betty Branum (VA)
Jack Brown (AL)
Polly Chan (CA)
Christopher DiLorenzo (CT)
Karen Dyke (NE)
Roy Foster (NC)
Mark Gardner (USI Holdings)
Kendra Godbout (ME)
Angela Hatchel (NC)
Larry Hawkins (LA)
Martin Hazen (KS)
Weldon Hazlewood (VA)
William P. Hobert (AZ)
Katie Johnson (VA)
Patrick E. Kelly (DC)
Leslie Krier (WA)
David Langenbacher (CA)
Theodore Lehrbach (AK)
Craig L. Leonard (NAIC)
Gina McBride (ID)
Jim Mealer (MO)
Randy Moses (SD)
Mark Noller (MS)
Bruce Ramge (NE)
Eugene T. Reed Jr. (DE)
Daniel Stemcosky (PA)
David Towanda (CA)
Max Vega (DE)
Debra Vernon (MS)
Kirk Yeager (Unaffiliated)

Internet insurance sales never matched the hype

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As Bisker put it in the same article, "Attitudes, infrastructures, business climates and regulations all change at different rates."

Infrastructure hasn't held back online sales, not with the growing penetration of broadband access, ever-faster computers and sophisticated Web-based tools. And the business climate would certainly seem to favor the convenience and lower costs associated with online anything. Regulation hasn't been a hindrance either.

That leaves attitude. Sure enough, there seems to be a consensus that consumers' attitudes are the big reason that online insurance sales have grown but not exploded.

"No one wants to buy insurance," said Sal Castiglione, chief of New York's Consumer Services Bureau. "Insurance is something you buy and never want to use.

"I think people are just naturally afraid of insurance, and they need to have that personal contact with a person — they just don't trust themselves to understand what they're buying on the Internet."

> ***I think people are just naturally afraid of insurance - they just don't trust themselves to understand what they're buying on the Internet.***
>
> **- Salvatore Castiglione, New York State Insurance Department**

In a way, insurance is a lot like, say, buying a car online.

Some amazing percentage of buyers — by some estimates, as many as 60-80% — show up at their local auto dealership with a good idea what model they want, what features they'd like — and what price they're willing to pay. Why? Because they've already been online, not to buy but to do a little research.

"The last three cars that I've bought," said Castiglione, "I've gone in there and they know that I've done my homework, and the price that the dealership gave me was the price I ended up paying.

"The days of the country bumpkin going in and getting ripped off are long gone. And that's because of the Internet."

And yet, for all the similarities, there are distinct differences. Most Americans own at least one car and at least one insurance policy. But while we drive everywhere and feel we know what autos are all about, we don't feel the same sense of confidence about our auto insurance.

We drive cars, we buy food from our cars, some of us live in our cars. But when we insure our cars, most of us stash away the policy without reading it.

"People are using the Internet as an information resource for insurance, the same way that they're using the Internet as an information resource for so many other things," said Ron Von Haden, executive director of the Professional Insurance Agents of Wisconsin.

"But while many people have an idea of what their insurance costs may be, they're very uncertain about buying over the Internet — about making the final buying decision — simply because they're not getting any professional advice. And they don't feel they have the expertise to make an educated decision."

Commoditization

OK, so maybe the typical American consumer gets all teary-eyed when he's forced to think about mortality and buy life insurance. And maybe annuities, health insurance and other complex coverages are too much to buy without someone sitting across from you at the kitchen table and going through all the variables.

But auto insurance? Come on, it's a commodity. You don't need to know anything — dig out your current policy, go online, compare prices for the same kinds of coverage you've got now, and save big bucks. Ditto for homeowners.

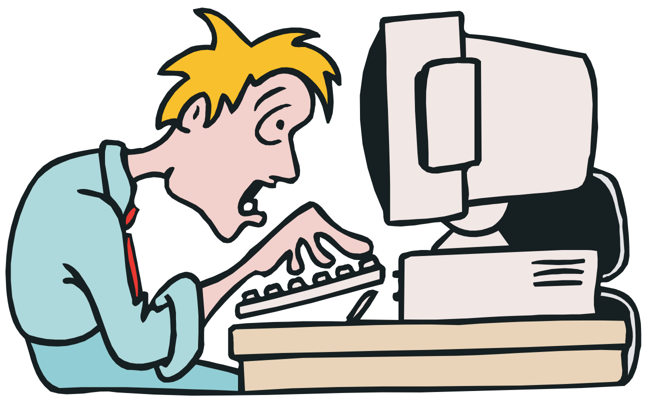
Yet as helpful as it is to get online quotes from dozens of insurers, a great many consumers still seem to put down the mouse and complete the sale at an agent's office.

Not that online sales haven't been growing. A recent survey by comScore Networks, a provider in the use of the Internet to measure and understand consumer behavior and attitudes, found that the total number of auto insurance quotes submitted online increased by 24% in 2005 compared with the previous year, and insurance policy purchases jumped by 29% over the same time period.

But year-to-year growth can look awfully good until you consider how low the base figure is. For instance, all online retail sales grew 24.6% last year — yet online sales totaled just 2.3% of all retail sales.

"The auto insurance sector has been slow to find its footing online," said Nicolas Tabbal, vice president of comScore's Financial Services Division, "but grew faster in 2005 than any other financial services category."

Other surveys show even a larger gap between shoppers and buyers, despite VoIP (Voice-over-Internet protocols — the buzzword for computer-based phone calls) and other technological means of letting online shoppers talk to a real person and get answers to questions.



Both Castiglione, the regulator, and Von Haden, who runs an association of independent agents, agree that in the real world, the sale still very often hinges on what the agent says.

After all, even if you can push a button and talk to someone at the company, that's still a lot of work, not a lot easier than calling up a local agent and talking to him or her. Especially if you think it through and realize that when you have a claim, that's the same person you'll be calling then.

As Von Haden put it, there's no www.byGodWhyDidn'tYouTellMeThis to click over to when you realize your policy doesn't cover what you thought it did.

On top of that, in most cases the insurance site will refer shoppers to a real agent to complete the sale. Many people probably stop at that point and say, Hey, why not just take this quote and call up the agent down the street? Especially since the local agent may well offer advice and service not available from some guy on the phone.

For instance, as Von Haden said, how about a newlywed shopping for homeowners coverage? The online outfit may offer a good price, but the agent would probably also think to ask whether you've got an expensive diamond ring that needs to be specifically insured. Otherwise, the limit on such a loss typically would be $500, which wouldn't be much comfort if you lost a $10,000 ring.

Online sales demand that you think of such things yourself. But as Von Haden put it: "If you didn't know what you were doing, perhaps you shouldn't have been doing it."

Online agents, Progressive

None of us are Luddites here. We're all willing to accept that the World Wide Web can do some things exceptionally well, and that the ability to compare quotes will enable online companies to continue to grow.

The point is simply that there are limits.

One of those limits stems from companies' relationships with their agents, whether captives or independents. Unless they're willing to get rid of all their agents and go entirely online, they've got to pay attention to those people's needs and interests. All of which helps explain why some insurers have been lukewarm toward the Internet.

What kind of penetration are you projecting — 10% online sales over the coming two years? 20% over five years? 30% over ten? That still leaves 70%, 80% or 90% of your business coming from traditional, nay old-fashioned channels. If you're an insurance marketer, that makes old-fashioned look awfully practical.

Take Progressive, which for the past year or more has been split in two: Progressive for traditional agency channels, Progressive Direct for the policies sold directly.

"What they found was that far and away, the biggest portion of their sales were coming through their agency force," said Von Haden. "And their loss ratios were lower on that business than their direct sales over the Internet or by their 800-number. They were

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Insurance on the web

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doing so much better through their agency force it was incredible."

The idea was sound — selling insurance to anyone in any manner they want to purchase it — but then reality intruded.

At the same time, those old, outmoded agents weren't sitting still.

Agents typically have gone online too, using technology not just to trade quotes and other information with their companies, but also to make themselves more readily available to that segment of the market that feels comfortable at least starting the transaction online.

One interesting sidelight is the role of the regulator.

At first it seemed that special efforts would need to be made to keep online operations honest. But in reality, the role of paraprofessionals has always been clear. Whether it's a clerk in an insurance agency or a clerk in an online operation, the dividing line between what they can do and say and what must be referred to a licensed agent or broker is quite clear.

Aside from pursuing the inevitable fraud and malfeasance, most departments seem to be taking a hands-off position and letting the marketplace do its thing.

As Von Haden says, no doubt speaking for agents everywhere, "I believe the market's working very well."

Predicting the future

Predicting what will be is best left to the supermarket tabloids. But sometimes you get lucky and hit the nail on the head.

Castiglione recalls a conversation with a co-worker in the late 1990s. The co-worker predicted that in the next decade we would see at least 30% of all insurance sold on the Internet.

"I said 'It ain't gonna happen,'" recalls Castiglione, "because people are not going to feel comfortable buying this type of product on the Internet. Fortunately or unfortunately, I was right."

"I still think people are mystified when they hear the word 'insurance.'"

Will that prediction continue to hold true in the years to come? We'll leave that to other, more accomplished seers. ■

C.E. News

Hassle-free Continuing Education with CEU.com

As the "Winds of Change" continue to move IRES in new directions, the Accreditation and Ethics Committee is excited to announce that it has now become easier for IRES members to earn Continuing Education credits — thanks to CEU.com.

In November 2005, IRES announced the pre-approval of online courses from CEU.com and added the listing to the NICE manual. Now IRES CE has been added to the CEU course catalog, so you don't have to remember which courses are pre-approved.

Navigate to the IRES CE listing in the course drop-down menu on the home page at CEU.com. You will have the most current listing of pre-approved classes and you won't have to deal with any continuing education paperwork. Once you successfully complete one of the approved CEU.com courses, CEU.com will take care of the IRES continuing education reporting for you. CEU.com will e-mail the IRES office directly with the necessary information for you to obtain your continuing education credits.

We've tried to make it as easy as possible for IRES members to earn CE credits through CEU.com, so please take advantage of this opportunity for hassle-free continuing education.

N · I · C · E

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The mandatory continuing education program for AIE and CIE designees

Insurance Regulatory Examiners Society

AL GREER ACHIEVEMENT AWARD

Nomination Form

The Al Greer Award was conceived in 1997 and annually honors a regulator who not only embodies the dedication, knowledge and tenacity of a professional regulator, but exceeds those standards. Current members of IRES Board of Directors are not eligible for nomination.

Basic requirements:
Five years as an IRES regulator member and a current member
Ten years of regulatory experience

Nomination procedure requirements:

(1) Completed nomination form
(2) Validation of nomination must be signed by at least one IRES regulatory member
(3) Attach a nomination letter of not less than 50 words or more than 100 words
(4) Send completed form and nomination letter to IRES by no later than April 30

NOMINEE INFORMATION:

Name: ____

Address: ____
Telephone: Work: ________________ **Home:** ________________

FAX: ________________ **e-mail address** ________________________

optional **Professional Designations:** ________________________________

Insurance regulatory experience:

____

____

Current Position and Employer:
(make note if nominee is a contract examiner and give jurisdiction currently contracted with)

____

NOMINATION VALIDATION:
(signature/name of IRES member making nomination)

____

Signature/Name

Please return completed form and nomination letter by no later than April 30 to: IRES (Al Greer Achievement Award), 12710 S. Pflumm Rd, Suite 200, Olathe, KS 66062

Selection Process

Nominations will be accepted from the date the nomination form is placed in The Regulator through April 30. All nominations must be postmarked no later than April 30 prior to the next IRES Career Development Seminar.

The Al Greer Achievement Award Subcommittee will then determine nominees who meet the basic requirements and nomination requirements.

Nominees making it through the sub-committee process will be voted on by the members of the Membership and Benefits Committee with the nominee receiving the most votes being the recipient of the award. In case of a tie the entire Board of Directors will vote to determine the winner. (In either instance, only one vote per committee member or board member.)

The counting of votes will be conducted by the Al Greer Subcommittee and verified to the chair of the Membership and Benefits Committee and executive secretary of IRES. The winner will be kept confidential until announced at the next CDS.

Title insurance and California's reforms

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would-be buyer who has found the perfect house rarely has the time or inclination to comparison shop for a title insurer. Moreover, in comparison to the enormous price of a house, the amount for title insurance can seem insignificant.

In most cases, consumers defer to their real estate settlement producer (such as a real estate agent or lender) for the choice of a title insurer. That dependence means that the majority of consumers may never understand the nature of their title insurance.

For the uninitiated, the following is a brief summary of the basics of title insurance in California.

- There are two basic policies: an owner's policy and a lender's policy. An owner's policy is issued to the buyer for the full purchase price of the property. A lender's policy is issued to the lender and will pay the lender the remaining principal on the loan if there is a title problem that cannot be resolved. Both policies are usually paid for by the home buyer;
- Unlike other insurance products that protect against future contingencies, title insurance insures the title at a particular moment in time against events that occurred in the past, such as mechanics liens or encumbrances;
- Entities engaged in the business of title insurance include at least three types of companies offering different services - an "underwritten title company" which prepares the title searches, examinations, title reports and abstracts of title; a "title insurer" which issues the title policies; and an "escrow company" which prepares the real estate settlement documents for closing;
- Escrow services may be offered by the title insurer; and
- Premiums are generally calculated as a function of the purchase price of the home.

Even more significantly, consumers are also generally unaware that they may have paid too much for title insurance. A study from A.M. Best showed that from 1995 to 2004, the title industry paid less than 5 cents per premium dollar for claims, compared with 80 cents per premium dollar for the property and casualty insurance industry. In the typical title insurance transaction, the majority of expenses, including those to examine, underwrite and perform a title search, are incurred prior to the policy being issued. Accordingly, unlike most property and casualty products, expenses associated with the cost of paying claims do *not* drive the costs of title insurance.

Establishing Reinsurance Affiliates

However, studies such as A.M. Best's beg the question: if claims expenses do not drive the costs of title insurance, what does? In August 2005, the California Department of Insurance reached agreement with nine major title companies that required them to pay $37.8 million in refunds and penalties for illegal rebates paid to real estate professionals. The illegal rebates were an incentive for the real estate professionals to direct home buyers to purchase title insurance from the colluding title companies.

> ***"Real estate professionals, at the direction of the title companies, created reinsurance company affiliates as a repository for 'ceded' reinsurance premium from the title insurance transaction."***

Real estate professionals, at the direction of the title companies, created reinsurance company affiliates as a repository for "ceded" reinsurance premium from the title insurance transactions.

The result of these transactions was that the real estate professionals stood to pocket as much as 50% of the title insurance premium, along with an obligation to pay 50% of the losses associated with the reinsurance transaction. Because title insurance losses typically make up less than five cents of the premium dollar, however, the resulting rebates to real estate professionals were often substantial. As part of the settlement, title insurers agreed to stop using captive reinsurance business arrangements in California, but admitted no wrongdoing.

A Study Commissioned

Following these settlements, California Insurance Commissioner John Garamendi continued to observe a number of alarming characteristics in the title insurance market: a high level of consumer unawareness, an unusual insurance product market, costs unrelated to expenses, and problematic relationships between the real estate settlement producers (brokers, developers and lenders) and the title insurer.

In short, the title industry presented a situation ripe for abuse. In response, Commissioner Garamendi commissioned a study of the title industry, authored by consulting economist Birny Birnbaum and released in December 2005. The study, *An Analysis of Competition in the California Title Insurance and Escrow Industry* [2] found that a reasonable degree of competition does not exist in California's title insurance and escrow markets and that rates charged in California are excessive.

> “*By eliminating excess expenses generated by the harmful effects of reverse competition and requiring lower rates during periods of greater real estate activity, the proposed rate regulation formulae provide strong incentives to title insurers to refrain from illegal kickback and rebate schemes at the expense of consumers.*”

The analysis found, among other things, evidence of “reverse competition,” *i.e*., marketing by California title insurers and escrow companies directed at real estate agents, mortgage brokers, and lenders who, in turn, direct the home buyer or borrower (the consumer who pays for the title and escrow services) to particular title insurers and escrow companies. The California competition study echoed the results of a 1977 Department of Justice report which, likewise, found reverse competition in the U.S title market, and determined the source of reverse competition: consumers' lack of knowledge and influence with respect to real estate transactions.[3]

The following section of the Justice Department Report indicates the extent to which the title insurance market had remained unchanged over the past three decades:

- Perhaps nowhere in the economy is there such a maldistribution of economic knowledge and power than in the finance and real estate markets.
- Sellers in particular and those choosing the source of title insurance for the ultimate buyer are generally quite well informed as to what is offered in the market. Those who actually pay for policies are as a rule notoriously uninformed as to the sellers and the services they provide.
- Due to lack of knowledge, lack of time, and lack of interest, the purchaser of a title insurance policy frequently exerts little, if any, influence on the selection of sellers. Although the person who pays for the title insurance policy could determine the seller, he usually does not, relying, instead, on his real estate broker, mortgage banker or attorney to direct the business to the most suitable insurer.

In other words, competition in the title insurance business is directed at the producer of the business rather than the consumer. A title company wishing to increase its market share would not necessarily try to reduce prices or improve coverages in order to attract retail purchasers of title insurance. Rather, the company would seek to influence those brokers,

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Title insurance and California's reforms

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bankers and attorneys who are in a position to direct the title insurance business to it. The most direct manner of influencing this is to grant the producer of the business a fee, commission, rebate, or kickback – to the detriment of the title insurance purchaser. This is the phenomenon of reverse competition.[4]

Recognizing that California home buyers and sellers were being forced to pay higher premiums for title insurers' rebates and other unnecessary expenses, Commissioner Garamendi concluded that the price of title insurance in California failed to reflect the costs of writing the policy. Determined to put an end to excessive title insurance rates, Commissioner Garamendi proposed new rules for title insurance and escrow rates in California in July 2006.

The proposed California regulations address the market's failures, including the adverse effects of reverse competition, by mandating maximum rates that can be charged, while allowing title insurance companies and those other entities involved in the business of title insurance to charge, at their election, lower rates.

As proposed, the rules work to monitor and prevent excessive title insurance rates through the implementation of three components of the regulation: 1) a comprehensive statistical plan; 2) the maximum rate formula; and 3) interim rate reductions.

The Statistical Plan

As part of his investigation of the title industry, Commissioner Garamendi requested and reviewed data from California's title carriers. Based on this data, Commissioner Garamendi concluded that the Department of Insurance needed more detailed industry data than currently provided. Not surprisingly, the proposed regulations contain a detailed statistical plan to both facilitate the collection of meaningful data and to develop "projection values."

The projection values represent factors that are designed to capture the effect of forces such as inflation, changes in labor productivity and changes in business volume and transaction size. The factors, derived from the statistical plan, are then used to establish an industry maximum rate formula.

The factors operate to protect consumers against higher rates during periods of increased real estate activity, while ensuring that title entities can appropriately adjust their rates to account for periods of decreased real estate activity. As in a competitive market, the proposed regulations account for the cyclical nature of the title insurance market and assume that as costs and business activity rise or fall, companies will adjust their prices to recover costs and make a reasonable profit without charging excessive, noncompetitive rates.

The statistical plan represents a wealth of detailed information about entities engaged in the business of title insurance. Informed by data from the statistical plan, the Commissioner will be in a position to provide a careful and detailed assessment of the characteristics that determine whether a rate is excessive.

Maximum Rate Formula

The proposed regulations establish the maximum thresholds for title insurance and escrow charges formulaically. The rate regulation formulae can be distilled into five equations:

- The first equation reflects the maximum charge for a title insurance policy of a stated amount of insurance. That charge is the sum of the maximum charges for a preliminary report and a title policy issuance.[5]
- The remaining four rate formulae – for preliminary report, title policy issuance, full escrow and subescrow – use the same general formula with different data inputs based on historical expenses and projections. The historical projections, derived from the projection values generated by the statistical plan, are inserted directly into the formula. The product of each of the five formulae represents the maximum charge for the particular product in question.

Using the rate formulae above, the regulations operate to protect consumers. The regulations establish a relationship between the costs of providing title insurance products and services and the price of those products and services. By eliminating excess expenses generated by the harmful effects of reverse competition and requiring lower rates during periods of greater real estate activity, the proposed rate regulation formulae provide strong incentives to title insurers to refrain from illegal kickback and rebate schemes at the expense of consumers.

The Interim-Rate Reduction

The maximum rate formulae will be developed over time. Both the maximum rate formulae and projection values are dependent on data collection (via the statistical plan). Accordingly, the formulae cannot take effect until the Commissioner receives the statistical plan data. The Commissioner has, therefore, proposed an immediate remedy to address excessive rates in the interim.

The Commissioner's interim-rate reduction regulations were proposed in order to place more immediate control over one aspect of excessive rates that is apparent even without the aid of a statistical plan: title premium increases based on home value appreciation. Thus, Commissioner Garamendi's rules seek to impose an interim-rate reduction for those companies that have taken advantage of recent increases in home price without a corresponding increase in the cost of providing insurance.[6]

After accounting for outside influences such as changes in title policy rates and coverage, variable costs and inflation net of productivity gains, the interim-rate reduction seeks to return rates to the levels in place in 2000 for home purchases, refinancing and escrow charges.

Conclusion

Title insurance remains a unique and confusing product for the average home buyer. Yet, it is an insurance product that is required for virtually every California real estate transaction. Recognizing the "maldistribution of economic knowledge and power" between the consumer and the real estate professional, California's set of newly proposed rules will operate to protect the consumer against expenses used to fund insurer rebates and kickbacks. These new rules will ensure that the Commissioner is armed with sufficient data to establish a maximum, nonexcessive title insurance rate in California and restore balance to the real estate transaction to assure consumers that they are purchasing a product that is reasonably priced and tailored to the consumer's benefit.[7] ■

Bryant W. Henley and Kim Morimoto are both Staff Counsel with the California Department of Insurance.

Endnotes

[1] California Insurance Law and Practice, 39.02[3] – Title Insurance Contrasted With Other Insurance (Matthew Bender 1995); DiMugno & Glad, California Insurance Law Handbook, 78:1 (Thomson West 2005).

[2] This study is available via the Department of Insurance's Web site: www.insurance.ca.gov.

[3] U.S. Department of Justice report entitled The Pricing and Marketing of Insurance: A Report of the Department of Justice to the Task Group on Antitrust Immunities (January 1977).

[4] The Pricing and Marketing of Insurance, pp. 254-257.

[5] A maximum charge is established for the preliminary report because the report is a discrete product that represents a major portion of the activity associated with issuing a title insurance policy. The total costs for issuing a title insurance policy are those for the preliminary report plus the additional expenses associated with issuing and maintaining the policy, including the settlement of claims.

[6] Current rate filings, many of which have been in effect since 2000, set the rate for title insurance primarily as a function of the exposure, or policy amount. Since the year 2000, the median home price in California has doubled. Thus, as real estate prices have risen in California, so has the price for title insurance, despite the fact that the cost of providing title insurance does not vary substantially according to the amount of insurance purchased.

[7] Commissioner Garamendi's proposed regulations were issued in July of 2006. A public hearing was held on August 30, 2006 to discuss the draft regulations and, as of the date of this writing, the review and consideration of public comments concerning the draft regulations continue.

"Quote of the Month"

"Why are the insurers getting let off the hook? I don't know why you'd pay for insurance and not take advantage of it. It sounds a little crazy to me."

— Jonathan Justice, Associate Policy Scientist, University of Delaware School of Urban Affairs & Public Policy, noting how many state and local governments buy municipal bond insurance and then decline to make claims when defaults occur in order to protect their credit ratings.

IRES State Chapter News

ALABAMA — The Alabama Society of Financial Examiners and the Insurance Regulatory Examiners Society sponsored ACL software application training by the NAIC's **Kirk Cummings** on September 25-29 at the Alabama Department of Insurance. The Alabama Department was accredited for a five-year period on September 22.
—*Cristi Owen; Cristi.Owen@insurance.alabama.gov*

CALIFORNIA — The California Chapter held a meeting on September 14. **Tessa Lucero**, AVP Marine Insurance, Marsh Risk & Insurance Services, presented an informative session on ocean marine insurance. Many more educational meetings are being planned.
—*Polly Chan; chanp@insurance.ca.gov*

LOUISIANA — The Louisiana Chapter meeting was held on August 17. **Molly Quirk-Kirby**, Legislative Coordinator for the Department, gave a summary review of the legislation enacted in the 2005 Special Session, 2006 Special Session and the 2006 Regular Session. According to Ms. Kirby, the legislation was drafted in response to Hurricanes Katrina and Rita. There were 31 in attendance. The Chapter held an Officers' meeting on September 21 to discuss speakers for future Chapter meetings. The Chapter calendar was updated to indicate which meetings would be for CE.
—*Larry Hawkins; lhawkins@ldi.state.la.us*

NEBRASKA — The speaker for the August chapter meeting was **Jina Ragland**, Program Director for the Nebraska Senior Health Insurance Information Program (SHIIP) with the Nebraska Department of Insurance. Ms. Ragland presented an overview of SHIIP activities and gave an update of what is happening with Medicare Part D and Medicare Advantage. **Cindy Williamson**, Consumer Affairs Investigator, recently received the AIE designation, and **John Koenig**, Market Conduct Analyst, received the CIE designation. Congratulations to both! Details of upcoming meetings can be found on the IRES Web site.
—*Karen Dyke; kdyke@doi.state.ne.us*

OREGON — At the August meeting, our group heard from **Mark Hurliman** of Oregon's Occupational Safety and Health Administration. His talk focused on injuries in the work place and how they affect workers' comp insurance premiums and eligibility for coverage. In September, Division Administrator **Joel Ario** spoke to the group. He discussed state initiatives in health insurance and also reviewed federal vs. state regulation issues.
—*Cliff Nolen; Cliff.Nolen@state.or.us*

VIRGINIA — The quarterly IRES Chapter meeting was held on September 25, with 19 regulators and Commission employees in attendance. **Doris Irvine**, **Carly Daniel** and **Paul Wilkinson** gave a presentation on last summer's Career Development Seminar held in Chicago.
—*Carly Daniel; carly.daniel@scc.virginia.gov*

If you have state chapter news, send it to Larry Hawkins at ***lhawkins@ldi.state.la.us***

How transparent should insurers be with regulators ?

by Joseph F. Bieniek
CPCU, ACP, CIC, ARC, AIS, AU

I am often presented with the following question: “Joe, we are dealing with a potential problem, should we tell state regulators about the situation?”

Or someone says, “We are completing a state data call, and we know our numbers are correct, but when the insurance department compares this to other information, we know it won’t look good and they are going to wonder what’s going on. What should we do?”

Simply stated for both situations -- a company needs to tell regulators what has happened.

Data Calls & Market Analysis

Insurance department data calls are increasing on a variety of topics and issues by state, and at the same time, market regulation is changing in each state. States are reviewing data in more detail to analyze what insurance companies are doing in the marketplace, and to determine whether they should be subject to a market conduct examination.

This process is called market analysis. Some states are also using a Market Conduct Annual Statement to gather data. Although the number of states varies between Property and Casualty and Life and Health, the main categories of data collected for specified lines of business include:

Property & Casualty
- Claims
- Underwriting
- Lawsuits

Life & Annuity
- Claims
- Underwriting
- Complaints

The submission materials in these Market Conduct Annual Statements include space for companies to provide additional information or comments related to the submitted data, and companies should not be hesitant to include explanations. Many companies do not provide explanatory information and then go into panic mode when they receive an inquiry from a state related to their data. All too often, they assume regulators will look at explanations as a “red flag” tipping them off to a problem and that it will lead to a full-blown market conduct examination. This simply is not the case.

When an insurance department is provided with a reasonable explanation of why the company’s data may seem inconsistent, in many cases that means it will not need to conduct further investigations or schedule a market conduct exam. This saves time, resources and money for both the company and for the state.

Of course, not all explanations are simple, but it’s always a good idea for an insurer to explain as much as possible up front.

Here are two scenarios, taken from actual cases:

- Company A did not provide an explanation of the material they submitted. The state could not help but notice a large amount of business dropped off the books, so they decided to conduct a market conduct exam to be sure the company terminated everyone correctly and to verify a withdrawal plan was not necessary.
- Company B provided an explanation with its data indicating why they nonrenewed a large portion of their business -- notice I used the term “nonrenewed,” as the company did. Precisely indicating that policyholders were nonrenewed let the insurance department know that policies were not cancelled mid-term. In addition, the company told the state they were processing the nonrenewal notices 75 days in advance (the state required at least 45 days notice) and that they provided each insured a specific reason for the termination. Company B did not subsequently undergo a market conduct exam.

For the most part, the exam of Company A went well. However, the company probably could have avoided the exam by alerting the state in advance about the dropped business. The problems uncovered in the exam had nothing to do with the large number of policies that were terminated, but the exam did reveal that the drop in business resulted from a large agency moving its business to another company leading to the terminations.

Company B's comprehensive response to this situation is what insurance departments are seeking through market analysis. Companies need to do their part in helping to streamline the process.

When a mistake happens

A much tougher situation occurs when a company discovers they have indeed done something wrong. Companies often do the right thing at this point -- they uncover the root cause of the problem, fix it, identify and correct policies or claim files, and create checks and balances to ensure similar situations do not occur in the future.

> ***Being straightforward with your regulator will help mitigate negative press, bad feelings and costly fines, and providing a full explanation will help even more.***

But sometimes companies wonder, "Should we tell the Department of Insurance?" The answer is yes. Even if you don't tell them about it, they will probably find out at some point. I have been involved in many discussions with companies and states over the years, and can tell you -- the Department of Insurance appreciates knowing when you know. They will take more kindly to the company being upfront and forthright with them, and depending on the situation, they may not even issue a fine or stipulation and consent order on the matter. However, if they find out about a problem through other means, such as an examination or complaints, fines are more likely to occur.

Being straightforward with your regulator will help mitigate negative press, bad feelings and costly fines, and providing a full explanation will help even more. The more information you can give your regulator, the better. Tell them what happened, how it occurred, when it occurred, when it was fixed or when it will be fixed, the number of policyholders or claimants involved and the total dollar impact.

Also, remember that time is of the essence: Let the state know about any problems as soon as possible. Sometimes problems come to light and it takes several months to fix the last policy or claim. Do not wait until the end of the process to inform the state. Provide the information early along with your plan of action.

Collaborating with your regulator in properly treating your policyholders and claimants is important and effective. The returns from the customers and the regulators will help you and your company in the long run, both in direct benefits to your top and bottom lines and in how you are perceived in the industry. Company stakeholders don't just want company profits to be as high as possible, they also require you to do the right thing, and reporting a regulatory deficiency is one of those necessities. Speaking with your regulators as needed and having an effective compliance program will help your company immeasurably.

Joseph Bieniek has 30 years of experience in the insurance industry. He joined the National Association of Insurance Commissioners as Statistical Information Manager this fall.

Welcome, new IRES members

Edward J. Bannister, DC
Joe F. Bieniek, NAIC
Chad Brown, LA
John Humphries, GA
Ismelda Hyland, LA
Randy D. Kemp, AIE, MO
Russell W. Meals, Jr., CA
William G. Niezgoda, NY

IRES Market Conduct Certification and new NAIC designations

by Douglas A. Freeman, CIE
IRES President

Thanks to the leadership of Gary Domer and Kate Bergan, the IRES Market Conduct Certification (MC+) Project is entering its second phase. MC+ is an IRES educational project to provide hands-on training for IRES members on how to efficiently and effectively run market conduct examinations. Scores of IRES volunteers have helped with MC+.

Phase One included detailed research and drafting of a course outline and textbook containing 24 chapters covering all aspects of how to run a market conduct examination.

MC+

Request for Proposals (RFPs) have gone out to potential vendors for Phase Two of the MC+ Project, which includes reviewing the 24 chapters drafted by IRES members and volunteers to ensure style and substance continuity and professional textbook standards.

Phase Three of the MC+ Program most likely will be a two-day training session with a multiple choice examination on the third day. Plans for regional MC+ site opportunities are being discussed.

Inspired by both regulator and industry interest, MC+ will first be geared to those IRES members with the Accredited Insurance Examiner (AIE) and Certified Insurance Examiner (CIE) designations who are Market Conduct Examiners-In-Charge (EIC). After a pilot project planned for the Spring 2007, IRES is hopeful to have some component of MC+ presented as part of the Pittsburgh Career Development Seminar (CDS) Sunday, August 12 through Tuesday, August 14, 2007, which will also be IRES' 20th Anniversary. Plans are to open the MC+ Program to other IRES members (regulators, independent contractors, etc.), insurance industry personnel, and other interested parties after refining the pilot project.

MC+ is the first of several supplementary designations to the AIE and CIE, which hopefully will be followed by other regulatory compliance specialty designations in consumer affairs and possibly other areas.

As the MC+ Project is being introduced, the NAIC is also introducing three new NAIC designations, which are available to regulators only. IRES believes the MC+ Project and the NAIC's designations complement each other by focusing on different aspects of regulation. Two of the three NAIC new designations, the Associate Professional in Insurance Regulation (APIR) and Professional in Insurance Regulation (PIR), are geared toward regulators beginning their career, while the third designation, the Senior Professional in Insurance Regulation (SPIR), focuses on the Deputy Commissioner level.

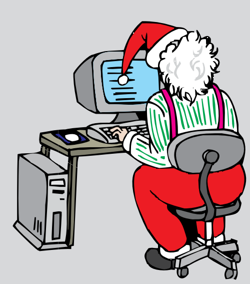
IRES believes the MC+ Program will be extremely valuable to all individuals involved in the market conduct examination process.

When the MC+ Program becomes operational, IRES hopes to work closely with the NAIC to determine how, if possible, the MC+ coursework might be used to also count toward one or more of the three new NAIC designations.

For more information about the NAIC new designations, please see www.naic.org/education_designation.htm.

For more information about the IRES MC+ Program, please contact Doug Freeman at dafreeman18@aol.com, or Gary Domer at gldwildkat@aol.com.

Happy Holidays to all our IRES members and friends, and best wishes for a great 2007.



Regulatory Roundup

by
Stroock & Stroock & Lavan LLP

California – Governor signs legislation regarding offsetting reinsurance premiums
On September 18, Governor Schwarzenegger signed into law AB 2400, a bill that permits a reinsurer to offset against its liability to an insolvent ceding insurer any premium owed by the ceding insurer to the reinsurer. In its analysis of AB 2400, the California Senate Committee on Banking, Finance, and Insurance (the "Committee") noted that under existing California law a reinsurer may not offset its reinsurance obligation by the amount of premium the ceding insurer owes to the reinsurer. The Committee offered the following hypothetical to illustrate the changes proposed by AB 2400: A ceding carrier cedes $100 million to a reinsurer and promises to pay $25 million in premium at a later date. The ceding insurer makes a claim for $100 million, but fails to make the $25 million premium payment. The ceding insurer then becomes insolvent, and the California Department of Insurance (the "DOI") assumes control of the insurer. Existing California law states that a reinsurer must pay "the portion of any risk or obligation assumed by the reinsurer." Hence, if the ceding insurer is due $100 million from the reinsurer, then the estate of the ceding insurer was entitled to receive the full $100 million as California law did not permit an offset of the $25 million owed to the reinsurer. AB 2400 accordingly was introduced to amend Section 922 of the California Insurance Code to permit a reinsurer to offset unpaid premiums due from an insolvent ceding insurer. In addition, AB 2400 also provides that all documents reviewed by the DOI in connection with an examination of a reinsurance intermediary are afforded confidential treatment to the same extent that those documents are confidential when possessed by an insurance company. To view AB 2400, visit the California State Assembly's Web site at **www.assembly.ca.gov**.

Louisiana – Supreme Court of Louisiana rules on the constitutionality of legislation passed in the aftermath of 2005 Hurricanes
On August 25, the Supreme Court of Louisiana upheld the constitutionality of House Bill 1289 ("the Bill"), which extended the prescriptive periods for insureds claiming damage resulting from Hurricanes Katrina and Rita to file a claim under their insurance policies to September 1, 2007 and October 1, 2007, respectively. Shortly following the passage of the Bill on June 29, 2006, the State Attorney General brought action against property insurers for a declaratory judgment to determine the constitutionality of the Bill under state and federal contracts clauses. Using a four-step analysis, the Court explained that while the legislation substantially impaired the contractual obligations of the insurance companies in the state of Louisiana, the significant and legitimate public purpose of protecting the ownership of insured property damaged by hurricanes underlying the Bill justified the regulation. Similar issues were addressed in neighboring jurisdictions affected by Hurricanes Katrina and Rita. Earlier this year, the Mississippi

continued on next page

The New York-based Stroock & Stroock & Lavan LLP Insurance Practice Group includes Donald D. Gabay, Martin Minkowitz, William D. Latza and William Rosenblatt. The Insurance Practice Group also includes insurance finance consultants Vincent Laurenzano and Charles Henricks. They gratefully acknowledge the assistance of Robert Fettman and Rachael Newman, associates in the group. This column is intended for informational purposes only and does not constitute legal advice.

continued from previous page

Department of Insurance issued Bulletin 2006-8, noting that Mississippi Code Section 15-1-5 nullifies any insurance provision attempting to change the time to file suit to less than three years, which is the time period insureds generally have to file suit for claims under their insurance policies (Mississippi Code & Section 15-1-49). The Louisiana Supreme Court decision was decided in *Louisiana v. All Property and Casualty Insurance Carriers Authorized and Licensed to Do Businesses in the State of Louisiana (*2006 WL 2498196 (La) 2006). To view Louisiana House Bill 1289, visit **www.legis.state.la.us**. To view Mississippi Department of Insurance Bulletin 2006-08, visit **www.doi.state.ms.us/bulletins/20068bull.PDF**.

KANSAS – Senate bill modifying commercial line rate scheduling

On July 1 the Kansas legislature enacted Senate Bill No. 539, which allows an insurer to increase or decrease some commercial lines premiums on a given risk basis up to 40% without being required to file a schedule rating plan. This premium modification procedure is used in schedule rating or individual risk premium modification. Use of this modification pertains to most commercial lines. Exceptions to this modification include farm owners, ranch owners, crop insurance, some medical malpractice coverage, workers' compensation and personal lines. Additionally, there are four changes to the filing of forms as follows: (i) forms pertaining to larger commercial risks are now exempt from the form filing requirements (insurers can use unfiled forms for these accounts, provided they comply with applicable Kansas law); (ii) personal line forms are now on file for thirty (30) days before becoming effective; (iii) forms for basic coverage required for workers' compensation are prohibited from being used until approved; and (iv) except as provided in item (ii), all forms are now effective as of the date of filing with the Kansas Department of Insurance or any subsequent date selected by the insurer. To view Bulletin 2006-07, visit **www.ksinsurance.org/legal/bulletins/2006-7.pdf**.

New Jersey – Department of Banking and Insurance proposes amendments to surplus lines regulations

On July 17, the New Jersey Department of Banking and Insurance (the "DOBI") proposed several amendments to N.J.A.C. 11:17B-2.1, which, among other things, would require an originating broker making surplus lines placements to disclose to the insured if such broker receives commission from a surplus lines producer for placing the surplus lines policy. The DOBI's summary of the proposed amendment noted that generally an insured will contact an originating broker, who in turn may contact a surplus lines producer, when insurance is required from a surplus lines insurer. The surplus lines producer often shares with the originating producer a portion of the commission received from the insurer. In that situation, the proposed amendment requires disclosure to the insured of the compensation arrangement. In addition to this disclosure rule, the proposed amendments also change the rules governing fees and commissions. The DOBI stated that these changes are meant to clarify the application of a statutory provision that limits the fees surplus lines producers may charge to originating brokers to $50, plus the actual costs incurred for services performed by a person not associated with the surplus lines producer, such as inspection services. To view the proposed amendments, visit **www.njdobi.org/proposed/prn06_221.pdf**

Casual Observations

Are you a Lovable Fool or Competent Jerk?

Perhaps you missed the study "Competent Jerks, Lovable Fools, and the Formation of Social Networks" when it first surfaced in the June 2005 issue of the *Harvard Business Review*. Having just discovered it, we found the results fascinating.

The researchers – Tiziana Casciaro and Miguel Sousa Lobo – collected data from four diverse organizations and MBA students. Overall, they analyzed more than 10,000 work-related relationships and identified four broad archetypes in the workplace. They are:

- **The Lovable Star:** This employee combines a winning personality with high-level competence.
- **The Incompetent Jerk:** This employee brings nothing to the table. A real zero.
- **The Competent Jerk:** This individual is extremely knowledgeable, but his personality turns off co-workers.
- **The Lovable Fool:** Although not incompetent, this person tends to be more likable than competent.

The study reveals nothing surprising with respect to #1 and #2: People overwhelmingly want #1 for their work groups and avoid #2 like the plague. However, what makes this research interesting is how participants reacted to working with the two middle-of-the-road choices: The competent jerk and the lovable fool.

Respondents strongly favored lovable fools for work partners over competent jerks. This flew in the face of what these same researchers found when interviewing managers. Managers, for the most part, said they would prefer competent jerks because as one supervisor put it: "I can diffuse my antipathy toward the jerk if he's competent, but I can't train someone who's incompetent."

So is it "unprofessional" to choose personality over competence? After all, by failing to choose the competent jerk we may be missing an opportunity to avail ourselves of his vast knowledge and expertise.

Casciaro and Lobo don't think so. They contend there are plenty of sound reasons to shun the highly qualified jerk. "Sometimes," say the authors, "it can be difficult to pry the needed information from him simply because he *is* a jerk. And knowledge often requires explanations to be useful . . . and this kind of interaction may be difficult with the competent jerk."

Competence \ Likability	Low	High
High	**Competent Jerk** *Mostly Avoided*	**Lovable Star** *Desperately Wanted*
Low	**Incompetent Jerk** *Desperately Avoided*	**Lovable Fool** *Mildly Wanted*

What are the lessons here? Well one is that the road to success is paved with more than sheer technical proficiency. We all strive to be more competent, but we should also recognize the importance of good working relationships with our co-workers. There may be no professional designations devoted to social relationships but — as this study demonstrates — those who fail to hone their social skills do so at their own professional peril.

— W.C.

BULLETIN BOARD

√ The IRES Executive Committee monthly minutes are now available at **www.go-ires.org**.

√ If you'd like to be on a panel, or put one together, at the IRES CDS in Pittsburgh next August, NOW is the time to let us know. Call IRES at 913-768-4700 and leave a message with David or Susan.

√ Want to run for the IRES Board of Directors? Now is also the time for that. Call the IRES office, or send an e-mail to ireshq@swbell.net.

√ *Hispanic Business* magazine recently selected IRES Foundation Board member Gary A. Hernandez as one of the 100 most influential Hispanics in the United States. Gary is a partner with the law firm of Sonnenschein Nath & Rosenthal LLP.

In the next REGULATOR:

A New Reinsurance Vehicle

Venture Capitalists, Insurance & Tax Breaks

BULLETIN BOARD items must be no more than 75 words, and must be accompanied by the sender's name, e-mail address and phone contact information. Submit plain, unformatted text without special font stylings, underlined hyperlinks or special margins and headings. A submission will be posted in the next edition of *The Regulator* as well as on the IRES Web site.

The Regulator®

Published by the
Insurance Regulatory Examiners Society
12710 S. Pflumm Rd., Suite 200, Olathe, Kansas 66062

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Whatever happened to buying insurance on the Internet? ***p.1***

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