Washington Research Council

e - Report

October 18, 1999

Time to Reorganize Insurance Regulation

Briefly

Proposed state legislation and problems in the market for individual health insurance have raised questions about whether Washington's insurance commissioner should be an appointive rather than an elective office.

In most states, insurance commissioners are appointed by the governor, which is consistent with the national trend of increasing gubernatorial authority and accountability.

Also, in 15 states, insurance regulation is one of the functions of a multipurpose state agency, which further shields insurance regulators from the influence of special interests. As well as insurance, the multipurpose agencies in these states regulate banks or securities or both, reflecting the increasing integration of these businesses in the marketplace.

Washington's legislature should place insurance regulation in the Department of Financial Institutions.

Late in Washington's 1999 legislative session, a bill was introduced that would change the state insurance commissioner from an elective office to one appointed by the governor. Though Gov. Gary Locke has remained silent on this issue, the bill is consistent with the desire of postwar Washington governors to augment their appointive and administrative power.

Every governor during the past 50 years has wanted to reorganize the executive branch, to some greater or lesser degree. Typically, they have sought more control and consolidation of the state's numerous agencies and commissions in the name of accountability, efficiency and effectiveness.

This trend has been national as well as local. Academics observe that there has been a long-term drive among states to centralize executive-branch functions, to reduce the number of independent commissions and agencies.

In Washington, the Office of Insurance Commissioner has been an independent, elective office since early in the 20th century. In 1889, the state's first legislature made the state insurance commissionership an ex officio function of the secretary of state. Then in 1907 lawmakers split off the commissioner as a separate executive post.

Today, the insurance commissioner is one of nine statewide elective executives. As well as the governor and insurance commissioner, these executives include the lieutenant governor, secretary of state, treasurer, auditor, attorney general, superintendent of public instruction and commissioner of public lands. Voter election of all but the insurance commissioner is required by the state's constitution. The legislature has the power to abolish the constitutional offices of lieutenant governor, auditor, and commissioner of public lands at its discretion.

Should the legislature convert the office of insurance commissioner into an appointive office?

This issue has surfaced as a result of controversy swirling about the current commissioner and the crisis in the market for individual health insurance. The legislator who introduced the bill accused the incumbent commissioner of using her office for political gain at the expense of the maintaining a healthy insurance market.

The commissioner has positioned herself as the consumer's champion for accessible and affordable health insurance. She has indefatigably opposed insurer rate increases. During her tenure, however, the market for individual health insurance has all but collapsed.

" ... organized interests find it easier to influence specialized agencies ..."

- Marc Roberts

Though hotly critical of the commissioner, the senator insisted that her actions were not the reason for his bill. "She's not the problem; the elected office is the problem," he said. In most states, the insurance commissioner is appointed. "That takes the politics out of the office."

Insurance commissioners are elected in only 12 states: California, Delaware, Florida, Georgia, Kansas, Louisiana, Mississippi, Montana, North Carolina, North Dakota, Oklahoma and Washington. In Florida, the commissionership will become a gubernatorial appointment in 2003.

What makes the insurance commissioner's office so political?

It is the fact that the office is an elective, single-purpose and independent agency with a lot of power to affect our pocketbooks.

During a 1987 symposium, Organizing for Modern Management, sponsored by the legislature and the Washington Roundtable, Harvard political economy professor Marc Roberts made the following point about single-purpose agencies: "One thing we know is that organized interests find it easier to influence specialized agencies than to influence multipurpose agencies. If there is something that is happening in the Fisheries Department that is of interest to the fish people but not to others, the fish people follow it and lobby, the rest of us don't.

" The result," he added, "is the multiplication of claims and a government organized to respond to them" rather than to society as a whole.

Neighboring states have organized their insurance departments such that they are more insulated from special-interest pressures. In Alaska, the Division of Insurance is one of seven divisions within the Department of Community and Economic Development.

In Oregon, insurance regulation is part of the state Department of Consumer & Business Services. The department is an umbrella agency for many regulatory functions, including insurance, banking, workers compensation, securities and building codes. The department's director, who is appointed by the governor, is the ex officio insurance commissioner. The current director, Mike Greenfield, has delegated his regulatory insurance authority to one of his deputies, who heads the department's insurance division.

Greenfield's opinion is that elected insurance commissioners may tend to make political calculations when dealing with insurance companies and consumers, whereas appointed commissioners "make decisions on not as much a political basis."

In Idaho, the insurance department is an independent agency, but the commissioner is appointed by the governor. Commissioner Mary Hartung, who previously served some years in the Idaho legislature's house and senate, has no problem with being appointed: "I'm delighted I don't have to run a campaign. I don't have to spend the entire time looking to the next election. I can spend more time and energy serving consumers and regulating evenhandedly without thinking how it will play out in the next election. I don't have to worry how it will look, how people will vote, and base my decisions on that."

In 1994, three Portland insurance-defense lawyers with the firm of Bullivant, Houser, Bailey, Pendergrass & Hoffman penned an article, "Elected Insurance Commissioners and Catastrophic Losses: Helping to Resolve Claims But Occasionally Overreaching," published in the spring volume of *The Federation of Insurance and Corporate Counsel Quarterly.* They suggested that elected insurance commissioners are tempted to undermine the insurance market to win votes from underinsured consumers.

Their premise: "In the face of catastrophic loss, state insurance commissioners can fill a vital role in ensuring that all claims are resolved fairly and quickly. Occasionally, however, pressure from underinsured consumers forces insurance commissioners to overreach and attempt to create coverage where none was intended."

"Because regulation of insurance rates is becoming politicized ... wealth redistribution will come to hold center stage among the various regulatory goals,"

- Benjamin Zycher

"After a natural disaster," the authors said, "elected insurance commissioners may face significant pressure to respond to the underinsured voters' demands for increased coverage."

By way of example, they analyzed a bulletin that Washington's insurance commissioner issued following the destructive 1993 windstorm. The commissioner indicated that homeowner policies could cover more damage than their policies indicated, even though the language of the policy contracts was unambiguous.

Warned the authors, "For the short-term benefit of a few consumers, interventionist insurance departments risk higher premiums for all policyholders and the potential insolvency of some insurance companies."

Analysis suggests that the office of insurance commissioner is highly political now because insurance rates have become a popular means of redistributing wealth, through implicit subsidies resulting from commissioners forcing low-risk groups to pay higher premiums in order to keep rates relatively low for high-risk groups.

"Because regulation of insurance rates is becoming politicized, which is to say, subjected to fierce interest group competition, wealth redistribution will come to hold center stage among the various regulatory goals," according to Benjamin Zycher, research vice president at the Milken Institute for Job and Capital Formation. "And the growing politicization of rates means that the politically ambitious increasingly will be drawn toward insurance rate regulation as a stepping stone upward," Zycher wrote in "Insurance Price Controls, 'Affordability,' and Taxation by Regulation."

Robert Detlefson, a senior fellow with the Citizens for a Sound Economy, believes the root problem with insurance commissioners lies in the extraordinary power they have to fix insurance prices, as well as to influence coverage offered to the public. And when the office of insurance commissioner is an elective one, Detlefson said, it's likely that election campaigns will degenerate into contests between candidates promising the lowest prices and sweetest deals for consumers. Moreover, electing officials with so much power over a single industry enables special interests to concentrate their campaign contributions and lobbying.

"The governor's authority should reflect the governor's responsibility. As long as the constitution requires a plethora of independent officers who inhibit the governor's authority, there will be frustration. The public does not realize the degree of fragmentation. They hold the governor responsible for everything the state does."

- Dixie Lee Ray

To attenuate this corruptive interaction between commissioners and interest groups, states should put insurance regulation in the hands of a chief executive – the governor or a multi-agency director – responsible for administering multiple regulatory functions.

Since the 1950s, Washington governors have called for making more independent commissions and agencies accountable directly to them, and hence to the general public.

Twelve years ago, a report by the Research Council – "The Reorganization of Washington State Government: The Power to Govern" – made the following observation: "From Albert Rosellini through Booth Gardner, the five governors who have served Washington since 1956 have been both consistent and persistent in their calls for a reorganization that would let them run state government 'like a business.' All five governors have sought some sort of streamlining that would give them more power, and thus a greater ability to complete their agendas."

By the time of Gardner's tenure, some dozen executive-branch reorganization studies had been published. All said the governor should have more managerial authority to further economy and efficiency in state government.

Gardner and his predecessors agreed that officials managing the state's major programs should report to the governor. Said former governor Dixie Lee Ray, "The governor's authority should reflect the governor's responsibility. As long as the constitution requires a plethora of independent officers who inhibit the governor's authority, there will be frustration. The public does not realize the degree of fragmentation. They hold the governor responsible for everything the state does."

The public sees state agencies as part of state government, and the governor as head of the government. When major problems arise, the public expects the governor to do something about them. However, directors of independent agencies can thwart the governor.

In 1987, the Superintendent of Public Instruction actively opposed Gov. Booth Gardner's plan for statewide teacher salary schedules. In 1999, the Insurance Commissioner impugned provisions of legislation promoted by Gov. Gary Locke to remedy the health insurance crisis.

During his administration, Gov. Gardner urged a constitutional amendment allowing governors to propose executive reorganization plans to the legislature. Proposals would become law unless rejected a majority of either house.

"Without greater formal administrative authority over agencies," Gardner said, "governors find it very difficult to implement management efficiency across state government and ensure consistent policy formation and implementation."

"My goal," he explained, "is to streamline the structure of state government and make agencies more responsive to management initiatives and more accountable to the general public."

Gardner asserted that because the state supported some 400 boards, councils, commissions and the like, "the public is genuinely confused about how state government functions and who is accountable for its operations." Only 33 of the state's 97 agencies were reporting to the governor.

"the public is genuinely confused about how state government functions and who is accountable for its operations."

- Booth Gardner

Gardner listed the reasons for giving Washington governors more power over the executive branch, including these:

- A clear, direct line of authority between the governor and those agencies for which he is responsible.
- Accountability to the general public through direct gubernatorial appointment and Senate confirmation of agency executive directors.
- A simple structure that the public can understand.
- Flexible, adaptable internal agency structures.
- Elimination of functional duplication.

An argument against more gubernatorial appointive power is that independent boards, commissions and agencies are free from the influence of governors and their political machines, that they are a vital part of our system of checks and balances.

Obviously politics affect the decisions of governors. That's undeniable. But unlike the heads of independent, single-purpose agencies, governors must balance the appeals of the many political interests across the state. They must build coalitions. They cannot win elections by catering solely to narrow special interests.

Harvard professor Roberts, who for 20 years served as director of the Kennedy School's program for senior managers in state and local government, spells out three reasons for making the state insurance commissioner a cabinet position appointed by the governor:

- Voter monitoring of elected officials. Voters can effectively pay attention to only a limited number of choices. In states with long ballots and lots of candidates, nobody pays much attention to relatively minor offices. In many cases, because the electoral supervisory function is weak, this leads to inadequate supervision of minor office holders.
- Coordination of policy across agencies. A fundamental argument for cabinet government is policy coordination, and accountability for lack of it.

- ❑ Service delivery. Our traditional fear of concentrating too much power in the hands of public officials has limited the scope of their managerial authority. In turn, this has contributed to the poor quality of various governmental services. The way to improve service quality, to achieve efficient and effective governmental services, is to make the governor the state's chief executive officer and ultimately responsible and accountable to the public for service delivery.

"This history of state governors' appointment powers is one of growth from weak beginnings."

- Thad Beyle

As chief executive, the governor should have the power to appoint agency directors.

By that standard, Washington's governors are relatively weak. On a scale of 1 to 5, the institutional power of Washington's governors, as measured by the number of a states separately elected executive offices, stands at the low end of the scale, according to University of North Carolina political scientist Thad Beyle, a contributor to the 1999 edition of *Politics In The American States, A Comparative Analysis*.

The governors of only nine other states rank equally as low as that of Washington, the only other West Coast state being that of California.

Also on a scale of 1 to 5, the appointive powers of Washington governors is 2.5, which is below the national average of 3.0.

"This history of state governors' appointment powers is one of growth from weak beginnings," Beyle wrote. "The increase of separately elected officials during the nineteenth century and the ad hoc proliferation of state agencies, often headed by boards and commissions, added to the problem of gubernatorial control. This diluted gubernatorial power was the background for twentieth-century reforms to increase gubernatorial appointive power. The assumption underlying these reforms is that governors who can appoint officials without any other authority involved can be held accountable for these officials' actions."

In 14 states, governors appoint the directors of agencies that include insurance regulation as one of their divisions:

In Alaska, the insurance division is part the Department of Community and Economic Development, which includes eight other divisions, one of which regulates banking, securities and corporations.

In Oregon, insurance regulation is housed in the Department of Consumer and Business Services, which also regulates financial institutions, building codes, occupational safety and health and other regulatory areas affecting consumers and workers.

In Colorado, the insurance division is part of the Department of Regulatory Agencies, which manages nine other divisions, including banking and securities.

In Hawaii, the insurance division is part of the Department of Commerce and Consumer Affairs, which includes six other divisions, of which financial institutions is one.

In Maine, the insurance bureau is part of the Department of Professional and Financial Regulation, which also regulates banking and securities as well as consumer credit and licensing and registration.

In Massachusetts, the insurance division is part of the Department of Consumer Affairs and Business Regulation, which also regulates banking as well as alcoholic beverages, medical registration, energy, and business.

In Michigan, the insurance bureau is part of the Department of Consumer & Industry Services, which manages 21 bureaus, agencies and other regulatory bodies, including the bureaus of Financial Institutions and Corporation, Securities and Land Development.

In Minnesota, insurance is regulated by the Department of Commerce, which also oversees financial institutions, securities, real estate and consumer protection.

In Nevada, the insurance division is part of the Department of Business and Industry, which also includes the Financial Institutions Division and some two dozen other regulatory bodies.

In New Jersey, insurance regulation falls within the purview of the Department of Banking and Insurance.

In South Dakota, the insurance division is part of the Department of Commerce and Regulation, which also oversees nearly two dozen boards and commissions.

In Tennessee, the insurance division is part of the Department of Commerce and Insurance, which also includes the divisions of securities, fire prevention, consumer affairs and regulatory boards.

In Vermont, insurance regulation falls within the Department of Banking, Insurance, Securities and Health Care Administration.

In Virginia, regulating insurance, as well as financial institutions, securities, retail franchising and railroads, is the responsibility of the three elected commissioners of the State Corporation Commission.

In all of these states, insurance regulation is handled by a department that also regulates either banking, securities or both.

Unlike these states, Washington houses the regulation of insurance in one agency, and banking and securities in another. Indeed, until 1993, banks, savings and loan associations and securities were regulated by different agencies.

Six years ago, the legislature created the Department of Financial Institutions, pulling together in one agency the tasks of examining and supervising state-chartered commercial banks, savings and loan associations, savings banks, trust companies, foreign banks, credit unions, consumer loan companies, and check cashers and sellers, as well as of issuing licenses or permits to securities brokers, franchisers, sellers of business opportunities, mortgage brokers and escrow agents.

It would make sense to move insurance regulation into the Department of Financial Institutions.

Integrating the oversight of all financial institutions, including insurance, would mirror the integration of financial services in the marketplace. Banks are no longer necessarily just banks, savings and loans no longer just thrifts, securities brokerage firms no longer just peddlers of stocks. They've all gotten into each other's business.

Washington Mutual Inc., for instance, is a savings-bank company that owns a commercial bank, a life insurance company and a securities firm. At one time, it also owned a property-casualty insurance agency. It still markets homeowners, automobile, flood/earthquake and mortgage life/disability coverage.

"Banks, which traditionally limited their insurance activities to selling credit life policies and annuities, have piled into the business since federal laws governing their insurance powers were loosened in 1996."

- American Banker

Wells Fargo, a commercial-bank holding company, offers auto, home and life insurance, though not yet in Washington. It also functions as a full-service securities brokerage. Among the products the bank markets are trusts, estate planning, mutual funds, bonds, individual retirement accounts, annuities and certificates of deposit.

Increasingly, banks are venturing into insurance. In a recent survey of its members, the Association of Banks in Insurance found that commercial-bank sales of insurance amounted to $8.6 billion, up 35 percent from last year.

"The trade group's survey, which drew responses from 407 banks, offers a rare glimpse at how banks are faring in the relatively new business of selling life and property and casualty policies through branches," *The American Banker* newspaper reported on Oct. 6. "Banks, which traditionally limited their insurance activities to selling credit life policies and annuities, have piled into the business since federal laws governing their insurance powers were loosened in 1996."

A recent survey by the American Bankers Association Insurance Association similarly concluded that banks are expanding their menus of insurance products. "Customers are asking to purchase all of their financial products under one roof, which is leading banks to add new products to their mix," said Larry LaRocco, the association's managing director.

On the national scene last year, Citicorp and Travelers Group shook the nation with the announcement of their planned merger, as Citigroup Inc. This gigantic bank- holding company now consists of Citibank, Travelers Property Casualty Corp., Travelers Life & Annuity, Salomon Smith Barney, Primerica Financial Services and several other large financial-services subsidiaries.

At the end of 1998, Citigroup said, "Travelers Property Casualty has already sold approximately 3,000 auto and homeowners insurance policies through the call center servicing Citibank's card operations. Primerica has opened some 1,000 new Citibank checking accounts through pilot cross-marketing programs in Atlanta and Las Vegas. Salomon Smith Barney brokerage clients interested in mortgage financing are now being referred to Citibank's mortgage operations."

Citigroup's future, though, depends on Congress amending federal law to allow banks and insurance companies to merge. Congress now is considering legislation, H.R. 10 and S. 900, that would repeal long-standing restrictions on financial institutions, further freeing banks, securities firms and insurance companies to affiliate with each other and enter each other's markets.

Some insurance trade groups, however, fret that without strict regulation governing insurance sales by banks, consumers may be misled. For instance, consumers may not understand that insurance policies are backed by the underwriting insurer, not by the bank selling them. Or they may believe that buying insurance from a bank is required if they want to take out a loan.

Such fears lend support to the idea that one-stop financial services in the market calls for one-agency regulation, with various divisions overseeing the various financial services.

Such fears lend support to the idea that one-stop financial services in the market calls for one-agency regulation, with various divisions overseeing the various financial services. A stand-alone insurance office will face greater difficulty in coordinating activities with other agencies. "Greater integration of financial services will increase competition and require more coordination among regulators of these different sectors," observes Robert Klein, author of "Structural Change and Regulatory Response In The Insurance Industry," on the website of the National Association of Insurance Regulators.

The case for coordinated regulation, under one roof, is buttressed by the blurring line between some financial products. Insurance agents, for instance, may sell variable annuities or viatical settlement contracts, both of which look a lot like investments.

In May, the Department of Financial Institution's securities director mailed a warning to local insurance agents: "We are sending you this letter in cooperation with the Washington State Insurance Commissioner's office. The Washington Securities Division is aware that insurance agents licensed and located in Washington are being solicited to sell viatical settlement contracts to their friends, relatives and customers. Under such a contract, a terminally ill person sells the death benefit in his or her life insurance policy in return for cash that can be used for current expenses. While this arrangement may provide some real benefits to the terminally ill, it can create major problems for individuals who sell the contracts and for investors.

"On the regulatory side," the director said, "promoters of these investments often claim that the investments are not securities and therefore the agents need not inform their broker-dealers of their activities or check with the Securities Division before selling the investments." But, the director declared, "It has been our experience that these investments often are securities under the Securities Act of Washington."

Conclusion and Recommendation:

Since the 1960's, as government has grown more complex, the efficient management of public institutions has challenged governors, in Washington and across the nation. Public administration, to a greater or lesser degree, always balances politics and efficiency. The governor occupies two important roles in state government. He is both the state's CEO and its CPO (chief political officer).

When political and managerial accountability are divided among numerous state-wide elected officials, the governor's ability to develop and implement a plan for governance is compromised. The trend over the last several decades has been to increase both gubenatorial accountability and authority.

In the Washington Research Council's earlier report, "The Power to Govern," the "plural executive" emerged as a major impediment to efficient execution of policy. Fragmented responsibility makes decision-making difficult and erodes accountability.

When accountability increases, so does efficiency. Governments across the nation have reorganized to clarify authority, responsibility and accountability.

Typically, reorganization follows functional lines. State agencies that have similar missions and that produce overlapping services combine into a single agency. Transportation and social service agencies, for example, frequently have been consolidated into single departments, as they have here.

The Office of the Insurance Commissioner in Washington is an anomaly. Most states treat the position as appointive, frequently placing it within an agency with responsibility for other financial services. Such an approach reflects the changes in the marketplace and reduces the influence of politics and special interests.

The recent legislative interest in placing responsibility for insurance regulation under a department head appointed by the governor opens the door to more efficient functional reorganization as well as to reducing the political pressures on the office.

Given the mounting challenges facing Washington's insurance market, the governor should be given executive authority commensurate with his political accountability.