[INSIGHT] By Peter H. Bickford

Report Cards - The Sequel

I received a number of calls recently from colleagues, including a couple of former NY insurance department employees, asking if I had seen the new report card on the effectiveness of each of the state insurance departments. Usually the conversation started out by the caller noting that California received an "F" and NY a "D". My initial reaction was that this was some kind of media gimmick to get back at regulators. My curiosity was piqued, however, so I did a little research. The report card was issued by the R Street Institute, a self-proclaimed "free-market think tank with a pragmatic approach to public policy challenges." The organization refreshingly admits to being on the political right, but also recognizes the need for some regulation, provided it is transparent and applied equitably. (The R Street Institute is a spin-off of The Heartland Institute, a conservative think tank that was targeted for some controversial stances, particularly on global warming.)

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My next thought was that the report card would be long on political positioning and short on actual substance. It turns out that the R Street 2014 Insurance Regulatory Report Card is a 34-page study designed to determine which state regulatory systems "best embody the principles of limited, effective and efficient government." The report tracked a number of categories including such topics as insurer solvency, fraud, consumer complaints, transparency, regulatory modernization, and the competitiveness of markets including home, auto and workers' comp. The report also admitted that it lacked good measures for other factors, such as regulation of insurance forms or the level of competition in local markets for insurance agents and brokers. It assigned factors and values to each of the categories studied to arrive at each state's score. In the tri-state area, New Jersey was the highest rated at B+, followed by Connecticut's B- and New York's D.

The response of state regulators has largely been muted. One exception was the impassioned defense by California's insurance commissioner, Dave Jones, of elected commissioners and Proposition 103, two factors that contributed to California's "F" in the R Street report. But this defense merely highlights the problem with report cards where the perspective of the grader is contrary to that of the graded party. It should not be surprising that a right-leaning assessment should give lower grades under its criteria to jurisdictions more intensely focused on consumers or enforcement than on the needs of the insurance companies. While the intent of a "free market" report card may be to incentivize states to make their regulatory systems more business oriented, it is not likely to have any significant impact one way or the other.

Regardless of one's political bent, at least the R Street Report Card was clear in its focus and criteria. The same could not be said about New York's 2012-13 report card on the response of insurance companies to Superstorm Sandy claims. For a number of months following the storm in the fall of 2012, the Department of Financial Services posted data on its website reflecting storm related insurance claims and complaints against insurers. These statistics were touted as a report card whose purpose was to "hold insurance companies accountable to consumers." Although referred to as a report card, the DFS did not assign any grades or criteria for assessing the data, and after several months showing that over 99% of all filed claims had been resolved or under review without formal complaint, the data slipped into the backwaters of storm coverage.

The DFS did not abandon the concept, however. In October 2013, almost a year to the day after Superstorm Sandy made landfall, DFS issued Insurance Circular Letter No. 8, Post-Disaster and Natural Catastrophe Regulatory Guidance (Emergency Disaster Protocol), which essentially reiterated its Sandy-related actions for application to comparable future events, including such actions as the moratorium on policy cancellations and acceleration of claim processing requirements on insurers. The circular letter also reinforced DFS's authority to require insurers to report extensive claim data relating to these events that it "would expect to use . . . to compile 'report cards' assessing the performance of insurance companies or for similar purposes." The directive did not provide any standards or grades, nor did it identify consequences for inadequate performance – the same failings as the original Sandy report cards.

It is a stretch to call the publication of collected data a report card without an accompanying set of goals or standards, or without defined consequences for failure to meet those goals or standards. On the other hand, issuing a report card on a positional bias, even if well intended and clearly stated, is also likely to be an ineffective agent for change.

The most successful report cards are those where the evaluators and the subjects have a common goal or where each is rewarded for improved performance by the other. For instance, educational report

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cards can be equally effective in measuring the performance of teachers as well as providing an incentive for students to achieve good grades, whether for college admissions, securing a job or even to ensure one's ability to play sports. In such a case, a report card can be mutually beneficial. Unfortunately, neither the R Street Report nor the Sandy report cards provide mutual incentives for improved performance because there is no evident commonality between the scorer and the scored. However, between the R Street Report and NY's Sandy report card, it is the Sandy report card that has the greatest potential to achieve a mutually beneficial evaluation system – and one that could actually provide important information for consumers!

It is unlikely that the R Street Report or any positionally slanted assessment, no matter how well constructed and supported, will change any state's basic approach to insurance regulation or its regulatory framework. On the other hand, there is significant potential commonality among regulators and insurers in responding to catastrophic events. Each has incentive to respond quickly and efficiently, and to minimize negative public reaction. Therefore, each should be able to agree to a measurable standard acceptable to all, and that would also have an educational value for consumers. But this can only be achieved through dialogue among the regulators and the companies – dialogue that has been sorely lacking in the recent past.

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The problem with NY's Sandy report card was that it did not seek to find common ground among the regulators and the insurers to establishing meaningful goals and objectives, or to provide useful information for consumers. The potential to do so remains, however. What is needed is the willingness to start a dialogue, preferably before the next disaster.[IA]

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