

## **A Bad Pitch to Mr. Miracle**

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**INDIANAPOLIS - To grasp where the Indiana Insurance Department ranks in this state's government, drive west from downtown Indianapolis along Washington Street.**

**On the right sprawls a six-year-old state office complex, occupying nearly six blocks and rivaling in grandeur many federal buildings in Washington. It houses nearly all state agencies, from the Finance Department to the Office of Barber Examiners, in spacious quarters surrounding atriums, wide hallways and a landscaped courtyard with fountains.**

**Directly across the street, between a bar and a dusty parking lot, sits a small, dilapidated structure, built in 1919 as a home to a department store. It houses the Insurance Department.**

**Sally McCarty, who last July became the agency's fifth commissioner in six years, says the shabby entryway, the single slow elevator and the windowless warren of offices "don't give you a positive image of the Department of Insurance or state government." Even a frequent adversary, Stephan A. Williams, president of the Indiana Insurance Institute, the lobbying arm of Indiana's property and casualty insurers, calls the department's headquarters "a hellhole."**

**The problem isn't that the department is a money loser. In fact, it is a gold mine, contributing about \$140 million a year to the state's budget - the second-most of any agency - from taxes and fees. But the governor and state Legislature let it spend only slightly more than \$4 million.**

**And on this, Ms. McCarty says, the department has a hard time regulating the more than 1,800 insurance companies it licenses. The tiny budget, along with laws limiting the department's enforcement powers and a generally warm relationship between state Legislature and the insurance industry, have combined to give Indiana one of the least-effective insurance departments in the nation. But its problems - and their causes — are by no means unique. To understand this department is to understand much about insurance regulations in America.**

**Since 1945, Congress has left the regulation of the insurance industry to the states. Today, although more than 500 companies each sell policies in all 50 states, the industry and state insurance commissioners have fended off attempts to impose regulation from Washington, arguing that states are best suited to protecting consumers.**

**Recent developments have cast a harsh light on the effectiveness of state regulation, though. Evidence presented in class-action suits across the country have shown that state regulators in the 1980's and early 1990's failed to detect widespread sales fraud by several of the nation's biggest life-insurance companies, despite thousands of customer complaints. States took disciplinary action only following press reports of abuses and after customers filed lawsuits.**

Consumer groups and some state regulators cite growing numbers of complaints that insurance companies are arbitrarily refusing to pay some homeowners and automobile claims, or are systematically "low-balling" customers, offering to pay much less than the full cost of repairs. There are also complaints of a trend, confirmed by some companies, of canceling or refusing to renew coverage of customers who have filed even minor claims.

Above all, the bond between regulators and the industry is growing tighter. Beginning in 1994, governors increasingly have appointed insurance-industry executives to be insurance commissioners. Of 21 commissioners appointed in 1995, for example, seven came from the insurance industry. In turn, many insurance commissioners recently have left their posts for high-paid jobs with insurance companies; insurance commissioners in at least four states made such a switch in 1997.

The problems are especially acute in Indiana, where a detailed examination of more than 1,000 consumer-complaint files — primarily involving the companies that drew the largest numbers of complaints — shows that the department rarely does anything in response.

Far from defending the department's record, Ms. McCarty and her staff confirm that they have been unable to take action even against companies that repeatedly refuse to pay claims and that mislead customers. The department received a record 5,278 consumer complaints in 1997, bringing the total since 1993 to more than 21,000. In the past four years, it has sent 211 warning letters to 72 companies, notifying them that they appear to be repeatedly violating the state laws. But the agency has taken disciplinary action against only 11, and only one of those was in response to consumer complaints. Ms. McCarty says that without a significant increase in staff, many complaints "can't get the attention they deserve."

The division assigned to investigate consumer complaints has no investigators on its staff, only "consumer consultants" who say they do little more than forward complaints to the companies. Indiana's is one of 13 state insurance departments that don't have an actuary on staff to examine the fairness of the rates companies charge. The department's total staff of 78 includes no examiners assigned to look into companies' sales practices. The agency pays little to its financial examiners — accountants who verify the financial soundness of companies and who make at most \$31,980 yearly — that it has a hard time attracting and keeping them. And its team of four lawyers spends most of its time defending the state's medical-malpractice compensation fund from consumer claims, leaving them little time or incentive to bring cases against insurers. (Regulation of rates and financial solvency emerged in the mid-19th century in response to consumer concerns about insurance companies' going bankrupt and not paying claims.)

All of this helps explain why insurance companies are flocking to Indiana. In 1994, consulting firm Conning & Co., surveyed insurance companies to find out which of the 50 states they believed provided the most insurer-friendly regulatory environment. Insurers ranked Indiana second, after Illinois, for insurance sold to individuals, and first for commercial insurance.

Since 1994, the number of companies licensed to sell insurance in the state has risen 8%, to 1,828, while the number of insurers with headquarters in the state has grown

nearly 13%, to 206. "Indiana has been a wonderful state for insurance companies to do business in," says Mr. Williams, the insurance lobbyist.

Ms. McCarty says that Indiana's intense faith that less government is better is only one reason there is little prospect for change. The other is in State Legislature, where the Senate's insurance committee is chaired by an insurance agent, and five of the 15 members of the House's committee work in the insurance business. The state is by no means unique in having key insurance legislators who also own insurance agencies. Only a small number of states, including California and Massachusetts, ban anyone with ties to the industry from serving on insurance committees. In Indiana, Ms. McCarty says, "you have the regulatees governing the regulators."

Weak enforcement played a role in a 1994 incident in which an agent of American General Life & Accident Insurance Co. urged Doyle Miracle of Wabash, Ind., to cash out a \$7,500 life-insurance policy he had had with the company for more than 15 years and buy a new one. At first, this didn't sound like much of a deal. The new policy would cost more than twice as much for the same amount of coverage. But the agent made an irresistible pitch: If Mr. Miracle, a forklift operator, became disabled, he would remain covered without having to pay monthly premiums. When lung cancer forced Mr. Miracle to stop working less than two years later, American General reneged. It said that Mr. Miracle was 56 years old when he bought the new policy and that the disability waiver didn't apply to anyone over 55. Mr. Miracle appealed to the Indiana Insurance Department. The department's practice is simply to forward a consumer's complaint to the company and pass along any reply that it receives. It has no authority to force a company to pay an individual claim. The agency swiftly closed out Mr. Miracle's file the way it does most complaints, checking a box marked "Company position upheld."

It did so even though American General had confirmed Mr. Miracle's allegations. In a letter to the agency, the company admitted that it had approved the policy and collected premiums from Mr. Miracle for well over a year, even though he had correctly stated his age on the application. American General also gave the department a copy of an internal memo disclosing that the sales agent, no longer with the company, was involved in a "blatant replacement activity" — a reference to the illegal practice of persuading customers to cancel policies and take out new ones solely to generate commissions. (A company spokesman denies that the agent did anything illegal while representing American General.) The memo also confirmed that the agent had promised Mr. Miracle the disability coverage.

Not until seven months later, when The Wall Street Journal inquired, did American General agree to fulfill the agent's promise. (American General said it re-evaluated the case and decided "it was the fair thing to do.") Mr. Miracle says his complaint "wasn't investigated at all" by the department. When asked about the material in the file, Betty Foy, head of the Insurance Department's consumer-services division, says the case was mishandled.

Ms. McCarty traces her department's problems in part to the early years of the administration of Democratic Gov. Evan Bayh, who served from 1989-97. When recession hit in 1991, Mr. Bayh slashed budgets and pressed all agencies to spend

less than allocated. Intent on keeping government small, the Bayh administration didn't ease restrictions when the recession ended.

This has left the Insurance Department with a staff that is 20% smaller than at the start of the Bayh administration, despite a major increase in the number of companies it regulates. The salaries paid to department employees are at or near the bottom in the country, according to the National Association of Insurance Commissioners, the organization of state regulators. The lawyers in the legal division receive the lowest salaries in the nation; the three "consumer consultants," whose job is to handle the thousands of consumer complaints, make a top annual salary of \$25,276, less than their colleagues in any other state except Tennessee. "These folks are expected to regulate a multibillion-dollar industry on a shoestring, and that just doesn't work," says Michealle B. Wilson, executive director of the Indiana Trial Lawyers Association and one of the most outspoken critics of the department. "There is a lot of pride taken in the fact that Indiana has a budget surplus and no tax increases. Well, this is the other side of it." Mr. Bayh denies that the department had been starved for funds, and says he considers its salaries adequate. "As far as I know, they've been doing a fine job," he says.

In keeping a tight grip on Insurance Department spending, Gov. Bayh was able to count on the support of the state Legislature. In the Senate, the powerful chairman of the insurance committee for the past 16 years has been Richard W. Worman, 64, Republican and former district manager for Nationwide Mutual Insurance Co. He is now a partner in an insurance agency that sells policies for companies such as Allstate Insurance Co. and Indiana Farmers Mutual Insurance Co.

From 1991 through 1996, Mr. Worman was the only senator to get a 100% rating every year from the Indiana Insurance Institute for supporting industry positions on legislation. So effective has he been at derailing bills the industry doesn't like that the Insurance Institute's 1997 legislative report gloated that the Senate had become "the 'killing fields,' burying nearly every negative proposal."

Asked if he thought it was a conflict of interest for him to chair the Senate insurance committee and sell insurance, Mr. Worman says, "It definitely is a conflict of interest — I should say, a conflict of interest potential." But he says he considers he has no more of a conflict than the farm-equipment salesman who heads the Senate agriculture committee.

Mr. Worman says that the Insurance Institute often drafts bills for his committee, and that its lobbyists are allowed to participate in committee meetings — not unique to Indiana. He adds that while the insurance industry does have an effective lobby in the Legislature, "I don't think you would find influence that would be against public policy to the point where the public would really be hurt."

In recent years, legislators in both houses have repeatedly killed bills meant to fight redlining — the refusal to sell insurance in certain neighborhoods, allegedly on racial grounds — in Indiana's inner cities. The insurance industry spearheaded passage in 1995 of one of the toughest tort-reform laws in the nation, sharply limiting punitive-damage awards and discouraging product-liability and negligence lawsuits.

Michael D. Smith, a member of the House insurance committee and head of an insurance agency, in 1996 infuriated Insurance Department officials by pushing

through a bill repealing a requirement that agents take a two-hour ethics course every two years. In an interview, Mr. Smith says the state shouldn't "micromanage" training.

Meanwhile, the Insurance Department is struggling just to keep track of consumer complaints. Administrative assistant Lana Riggle says she fields more than 200 phone calls a day from aggrieved consumers, in addition to her other duties. Her boss, Ms. Foy, says the five staffers in the consumer-services division spend much of their time trying to cajole reluctant insurers into paying claims, and sometimes succeed. When companies refuse, however, the most her staff can do is send the company warning notices that it appears to be violating the state's Unfair Claims Settlement Practices law and refer the files to the department's legal division. But her staff complains that the legal division almost never takes action.

One example: On April 19, 1996, a chain of severe thunderstorms roared through central Indiana, leaving in their wake hundreds of thousands of damaged homes. In the aftermath of the storm, about 50 customers who help homeowner policies with State Farm Insurance Cos. wrote to the department. In nearly identical complaints, they said that the Illinois-based company offered to pay far less than the costs of repairs and withheld payments until consumers agreed to settle. Convinced that the complaints had merit, the department sent State Farm 14 notices, warning: "We believe your company may have committed violations of the Unfair Claims Settlement Practices statute." (State Farm denies that it violated state law and says it didn't pressure its adjusters to make unfairly low offers.)

After complaints continued to come in, Ms. Foy says she asked the legal department to look into State Farm. But to date it hasn't taken any action. Ms. McCarty confirms that the legal department hasn't been able to do much. Part of the problem is that the legal department, with four attorneys, is small and inexperienced. The highest-paid lawyer is the new chief counsel, Amy E. Strati, 31, who makes \$38,000 a year.

Ms. Strati says the department makes up for its lack of legal resources by using outside law firms to evaluate the practices of companies that have generated large numbers of consumer complaints. These firms are often politically well-connected, and some derive much of their income from representing insurance companies as well. Since 1991, Ms. Strati confirms, no evaluation by an outside law firm has resulted in disciplinary action against an insurance company