Does your state insurance regulator make the grade?

When it comes to insurance, every state handles regulation differently, and this plays a significant role in whether a company wants to do business there. That's why the folks at the nonprofit public policy think tank R Street Institute thought it was important to produce the Insurance Regulation Report Card, which "grades" how all 50 states govern insurance companies.

The report, authored by R Street public affairs chief R.J. Lehmann and released June 4, 2012, measures 14 areas to determine which states "embody the principles of limited, effective and efficient government." In other words, the institute wanted to know which states were the most and least enticing to insurance companies.

"We're a free-market think tank. We believe in limited government and, more importantly, effective and efficient government," Lehmann says. "We wanted to measure which states were achieving that goal when it comes to insurance regulation."

Coming out on top were Vermont, Illinois and Ohio. According to Lehmann, these three states had the best environments for regulating property and casualty insurance, which includes coverage of cars and homes. All three states earned an "A+" grade; the best state, Vermont, earned 26 on a scale of 55.

On the other end of the spectrum was Florida, which was the only state to receive a failing grade. Other states that missed the mark were Alaska, Michigan, New York, California, Massachusetts and Texas.

"Because insurance is the biggest state-regulated industry in the U.S., a report like this offers us a way to compare how different regulations and laws really impact the market," Lehmann says. "You can see trends in insurance that you can't in an industry that is regulated the same way in every state."

What this means for consumers

The R Street report doesn't focus much on consumer issues like advocacy and fraud protection, one of the many things that troubles Amy Bach about the report. She is executive director of United Policyholders, a nonprofit group that advocates for insurance consumers.

"The fact that R Street) would prefer to have all state regulatory environments become more lax is all well and good, but it's kind of like my 11-year-old saying he would love it if I didn't make him go to bed at

10 o'clock," Bach says. "A regulator's job is not to make the state as comfortable an environment as possible for insurance companies. It's their job to balance solvency regulations with the needs of consumers whose premium payments fuel the entire system."

Bach adds that the report "just reinforces the idea that insurance companies don't like being told what to do."

Moreover, Bach says it's crucial for consumers to understand where the report's authors are coming from — namely that they favor less government regulation across the board and are biased toward that perspective.

Also, Bach says it isn't really fair to compare some of these states to one another because they all have different concerns when it comes to regulating insurance. For instance, Florida has more natural disasters than, say, Ohio, which affects the way insurance is regulated in the Sunshine State.

"It's all well and good for insurance companies to be able to charge whatever they please and argue that competition will keep everything healthy," Bach says. "But it's easier to have free competition when you don't have weather disasters and population challenges. You simply couldn't have a free-for-all in California or Florida or any other coastal disaster state because normal competition simply isn't going to keep the rates in check."

Mike Barry, a spokesman for the nonprofit Insurance Information Institute, isn't quite as pessimistic about the report. He says it's no secret that R Street has "a very pro-business, deregulatory stance" toward state insurance departments. That being said, the report will get the attention of state regulators, which could benefit consumers in the long run.

"I think this report card does a public service in that it gets the attention of regulators, and I think that's a worthwhile endeavor," Barry says. "They can always be improving their operations, and perhaps there are things in this report that will help them do that."

Making the grade

Of the 14 factors used by R Street to grade state insurance departments, some of the most significant included:

• How many home and auto insurers are in a state compared with the state's population.

• How robust the state's insurance markets are for consumers who can't obtain coverage through private companies).

• How effective the state's fraud regulations are.

• How transparent the state's insurance regulations are.

• How much freedom is given to set rates based on policyholder risks, such as driving records and claim-filing histories.

"We put all of those factors together to find those states that limit their interventions in the market to what is absolutely necessary," Lehmann says.

For instance, Lehmann points to Illinois headquarters of State Farm and Allstate), which is the only state in the country where insurers don't have to file rate increases with the state, even though they must make rate-setting paperwork available for regulators to review. The report says Illinois' "nearly pure free market" approach to insurance rates earned it 20 points in the study.

Conversely, the report claims states like Florida and Texas have "excessively stringent controls on rate freedom." Moreover, Lehmann says Florida lost considerable points because of state-run Citizens Property Insurance Corp., which has become the largest property insurer in the state.

"The problem with Citizens is that because they are owned by the state, they can set rates that are only about half of what most experts) say they should be charging," Lehmann says. "That means other companies in the state can't charge more than Citizens or they lose customers, but they also can't afford to compete because the rates are so low. That's not a very free market."

State regulators react

InsuranceQuotes.com reached out to insurance departments in Illinois, Ohio, Florida, Texas and California for their responses to the report. Representatives of the Texas and California departments couldn't be reached for comment.

Robin Smith Westcott, a former insurance regulator who now is Florida's appointed insurance consumer advocate, says her state's weak showing in the report probably stems from its poor reputation among insurers.

That reputation rests, in part, on "the instability of the political environment as well as the regulatory restrictions," Westcott says. "Many of these restrictions do originate with consumer protection in mind. However, there are times when the application of those regulations … makes Florida unattractive to do business for many companies."

Conversely, Ohio Lt. Gov. Mary Taylor, who also is the state's insurance director, praises her state's standing in the report.

"Our focus at the Ohio Department of Insurance is to maintain a predictable, stable and competitive marketplace that benefits Ohio insurance consumers. This emphasis has produced some of the lowest homeowner's and auto insurance rates in the country," Taylor says. "We are very happy with Ohio's ranking in this … study, and we will continue to focus on consumer protection while ensuring common-sense regulation of Ohio's insurance industry."

Jim Stephens, deputy director of the Illinois Department of Insurance, says his state's liberal rate-filing system fosters "open competition" and makes it easier for companies to react to changes in the market.

For example, Stephens points to states that require a stringent rate-filing process, like Florida and Texas. In those two states, insurers must seek regulatory approval for rate increases. Even when a rate increase is approved, that process can sometimes take up to a year. By that time, an insurer may want raise rates again, forcing it to lag behind the marketplace. Stephens says this process "can be so tedious and drawn out."