State Regulators May Be Undermanned as Duties Grow, Critics Warn

By Warren S. Hersch  September 23, 2019

A recent report released by the National Association of Insurance Commissioners has critics asking whether state insurance departments have enough people and resources to properly supervise carriers doing business there.

The national ratio of department budgets to revenues — which are collected from premium taxes, fees and fines — is less than 3%, according to the NAIC report. An analysis conducted by the Consumer Federation of America and the Professional Insurance Agents more than 20 years ago estimated that figure should be at least 10% for a department to be able to effectively take care of its responsibilities.

The federation still stands by that figure, which adjusts automatically upward as premiums rise, according to Bob Hunter, a director of insurance at the nonprofit. The organizations' research, he adds, shows that effective insurance departments spend on average more than 10% of revenue.

The matter has taken on a new urgency as products become more complex and principle-based reserving, in effect for less than three years, demands more flexible appraisals of how much money an insurer must set aside for future liabilities. Also, there are questions whether departments can properly enforce actions against agents who violate anti-fraud or consumer protection laws as stricter sales standards begin to be implemented.
“Many states do not have the horses to do the job of protecting consumers,” says Hunter. “This shortfall of budget is but one of the reasons that state regulation generally, with some exceptions, fails to adequately protect consumers.”

Consumer Federation’s Bob Hunter

Valmark Financial CEO Larry Rybka adds “I have serious concerns about how states with so few specialized staff, including only one life and health actuary, can in any way, check, monitor or police” principle-based reserving.

Three-fifths of all states have fewer than two actuaries that specialize in life insurance and annuities, according to the NAIC report. Eleven have none, including such larger states as Michigan, Wisconsin and Tennessee.

A Tougher Job to Police

The NAIC made principle-based reserving, a valuation model for calculated life insurance reserves, effective on Jan., 1, 2017. It lets carriers test and adjust reserving for products based on their individual risk experience. This contrasts with the previous model, which required them to use static formulas and assumptions. The older rule-based approach resulted in excessive reserves for certain insurance products and inadequate reserves for others.

But the greater flexibility enabled by principle-based reserving may make it harder for insurance departments to verify that reserves are adequate, given the heightened scrutiny of company financials that the model entails.

Valmark Financial CEO Larry Rybka

“In my opinion, PBR is a self-reporting system that allows companies to set their own reserves at a time when more not less oversight is needed,” says Rybka, referencing principle-based reserving. “The dramatic increase in reserves” for General Electric’s long-term-care insurance block “is but one example,” of that need, he adds.
About half of the staff and budget of state insurance departments is concentrated in four states: California, Florida, New York and Texas.

California had more than 1,400 individuals on the department’s payroll at the end of 2018. Texas had more than 1,460. New York, one of the states with the strictest regulations, had a comparatively lean, but still large team of about 760 employees.

One way to judge staffing levels is to compare the NAIC’s report’s totals with insurance premiums by state. Data from S&P Global shows that West Virginia’s department has, at 123.3, the largest number of department employees for each $1 billion in annuity and life insurance direct written premiums. Rounding out the top three are Montana with 85.1 and Vermont with 76.4.

States with the fewest employees per billion dollars of premium include Minnesota with 8.2 and Arizona with 9.7. Indiana is third with 9.8.

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Another useful measure is to compare the department staffing to the number of domestic insurers in each state. California has 100 workers for every insurer. By contrast Iowa has slightly less than three.

A stark contrast is also evident in the states’ budgets. Iowa’s budget for 2019 is $15.8 million and Nebraska’s is only $14.4 million. California’s 2019 budget is nearly $225 million, while New York’s is $157.9 million.

We're Well Staffed, Thanks

Bruce Ramge, Nebraska’s director of insurance, denied that the department has too few bodies.

“This department has the appropriate level of staffing and expertise,” he said by email. “Nebraska’s insurance laws, its financial examination staff and program are accredited and reviewed each five years with a stringent peer review conducted through the NAIC.”

Iowa’s insurance division takes a similar position. The department has the people they need, according to a spokesperson for the division. With a large number of life insurers officially based in Iowa, the state has greater duties to examine carriers’ increasingly complex financial structures, including holding companies, captive reinsurers and cross investments in affiliated companies.

Bryan Martin, the CFO of the Illinois Department of Insurance, said his state is adding employees this year. It had 204 full-timers as of June 30 and has budgeted for 58 more to be added by the end of the year.
Still, regulators need more experienced people to deal with increasing complexity as insurers accelerate their adoption of machine learning in their statistical models, said Daniel Schwarcz, a professor at the University of Minnesota Law School.

The developments are making it increasingly difficult for state regulators to meaningfully review insurers’ models to gauge their accuracy, he said.

State insurance departments don’t have in-house actuarial support or have limited resources to get help when reviewing rate filings that include use of predictive models, according to Schwarcz.

States increasingly rely on “analysts” to review the filings of insurers operating within their borders.

“Yet most analysts simply don’t have the technical background or experience to have the slightest chance of understanding at any level of depth the statistical rating and underwriting models that insurers are now deploying,” he wrote in an e-mail, recapping observations from a July 2019 white paper he authored.

Most such analysts are often hired right out of college and typically earning much less than they could make in private industry, he noted.

The NAIC can help address the expertise gap of state insurance departments, including in such areas as big data, predictive analytics and artificial intelligence, according to Peter Kochenburger, an associate clinical professor of law at the University of Connecticut School of Law. But, he says, the organization has “been stymied by industry groups for a number of years.”
Insurance Department Staffing

Number of staffers per state, adjusted for total life insurance and annuity premiums

Requested map does not exist.

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