The world's most dangerous insurance publication℠

SCHIFF'S

INSURANCE OBSERVER

November 18, 2002
Volume 14 • Number 16

The Wonder of Insurance Regulation

Economic Development

In the nineteenth century, American railroad companies sold land to Europeans using a timeless method: fraud. Cold, inhospitable prairie was advertised as warm and fertile farmland with a year-round growing season. Badlands were billed as tropical paradises. It wasn't "full disclosure," but it worked.

Selling land this way is now frowned upon, but selling whole states is not. Economic development agencies tout—and often exaggerate—the glories of their state in order to get companies to relocate there. Take Iowa, for example.

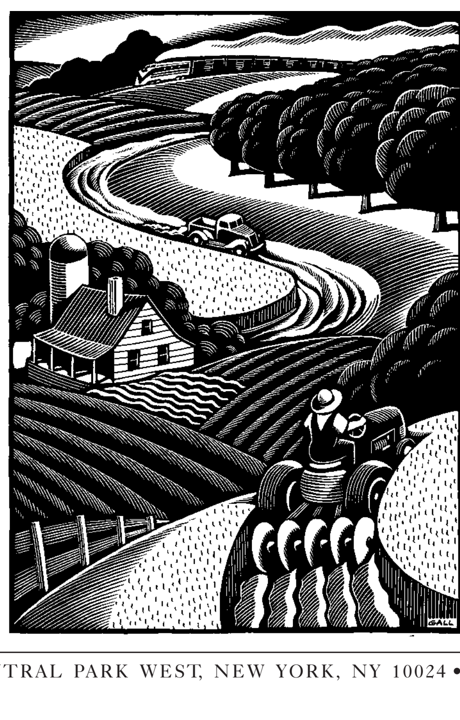
"Iowa's clean, uncongested cities have less traffic, less noise, and neighbors who are, well...neighborly!" says the Department of Economic Development. "Take in lively cultural events at night, from opera and ballet to symphonies and live theater."

Downtown Des Moines isn't much livelier than the Mojave Desert. That's why there's less traffic and noise. *The Des Moines Business Record* has lamented downtown's lack of nightlife. What little is left of downtown—it was intersected by highways years ago—is connected by a 2½-mile network of enclosed second-story skywalks. That way people aren't outside in the cold winters or the muggy summers. Pedestrians, needless to say, are few, as are stores and restaurants.

"Iowa's workforce provides a profitable advantage to New Economy companies," the Department of Economic Development says, promoting Iowa as a fine place for the "information solutions sector." The major Iowa "information solutions" companies listed on the Department's website are Aegon, AmerUs, ING, Nationwide, Principal, and Wellmark Blue Cross and Blue Shield. If Iowa's Department of Economic Development says these are "information solutions" companies, who are we to disagree?

A few years ago the Department of Economic Development ran a full-page ad in insurance publications plugging Iowa as "the smartest *community* around for insurance." The ad showed a photograph of a Principal Mutual employee with her three all-American-looking daughters in a public plaza in downtown Des Moines. The four are standing by a modern sculpture, and the two younger girls are reading books. (Who *stands* in a barren plaza reading a book?) Accompanying them are two neatly attired African-American boys, one of whom is also reading a book. This is a charming image, but it doesn't depict Iowa as we've seen it. Two of the six people in the ad just happen to be black. Iowa is no great melting pot, however; only 1.7% of its population is black.

The ad did hint at the *real* reason Iowa is a good location for insurance companies: "a progressive regulatory and business climate." "Progressive" usually makes one think of social idealism, Robert M. LaFollette, or Iowa's own Henry Wallace. Iowa's insurance regulatory climate isn't progressive in *that* sense. It's progressive in the sense that it's almost nonexistent.



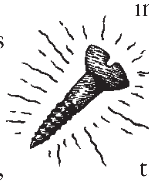
Des Moines, you see, is an insurance town. Almost every big office building belongs to an insurance company. The insurance companies are big, rich, and powerful, and they spread their money around when necessary. So important is the local insurance industry that the Iowa Historical Society Museum ran a huge exhibit, *We've Gotcha Covered: The Iowa Insurance Story*, for several years.

Insurance is a big money maker for Iowa. The insurance department took in \$146 million in fees and premium taxes last year, yet spent just \$6.7 million on regulation. The Iowa Insurance Department's logo is a black-and-white dog, and the Department's slogan is "The Consumer's Best Friend." With friends like the Department, consumers don't need enemies. The Department, time and again, has permitted or enabled big insurance companies to jackroll their policyholders.

Terri Vaughan, who's been commissioner since 1994, is an ersatz regulator. She managed to ignore dozens of dubious asset-stripping transactions at Allied Mutual (which has employed the services of her father as well as former Iowa commissioners William Timmons and Bruce Foudree), conducted sham regulatory hearings, and looked the other way while major mutuals deceived their policyholders.

Vaughan's actions and inactions have cost policyholders billions of dollars. Her official biography states that she "was responsible for implementing Iowa's mutual insurance holding company statute." Iowa was the first of 29 states to permit mutual holding companies (MHCs). Its statute was conceived of and drafted by the insurance industry, and Vaughan, perhaps naively, went along with it. She then became a big booster of the concept, even though it was exceptionally detrimental to policyholders.

While Vaughan was serving as Gunga Din for the MHC industry, a scandal blew up just a mile or so from the Iowa Insurance Department. In October 1997, *Schiff's* published an exposé of Allied Mutual—Iowa's largest property-casualty company—revealing how its senior officers and directors had, over a number of years, engaged in dozens of transactions that eventually siphoned well over $1 billion of value out of the mutual and into an affiliated holding company in which the officers and directors received a significant stake. The Allied Mutual scandal illustrated how ineffective and out of its league Iowa's Insurance Department had been. The Department had neither the budget nor the willpower to regulate large insurance companies adequately, and it apparently hadn't understood the ramifications of Allied Mutual's asset stripping and asset shuffling, some of which it approved. It didn't seem as if the ambitious Vaughan cared, anyway: she was stumping *in other states* for MHC laws that would permit mutuals to do what Allied had done and shift as much as $100 billion from policyholders. MHCs became one of the hottest insurance-industry topics in 1998 and 1999 and, eventually, the concept was pretty much discredited. Even Vaughan, in the eighth edition of her textbook *Fundamentals of Risk and Insurance* (1998), noted that the MHC "structure has become somewhat controversial, with critics charging that mutual insurance holding company arrangements deprived policyholders of their rights."



Although Iowa-domiciled companies including AmerUs and Principal were unable to satisfy provisions in Iowa's statute, Vaughan approved their MHC conversions anyway.

One could argue that the manner in which Allied, AmerUs, and Principal got the best of their policyholders was, actually, *good for Iowa*. After all, the vast majority of these companies' business is outside Iowa. Thus, permitting them to flimflam their policyholders doesn't hurt too many Iowans and is good for business in Iowa.

Insurance is regulated by the states, and much regulation is a race to the bottom—business heads for the state with the most lax (i.e., worst) regulation. Iowa is not the only state in which good regulation is less important than economic development, but it is a prominent one. (A departing commissioner in another state once told us he approved a large transaction he thought was wrong because he was afraid he wouldn't be able to get a job in the insurance industry otherwise.) Because Iowa has a relatively small population and a large insurance industry, the regulators have little power—or are afraid to exercise their power.

Vaughan is still busy doing what a good Iowa insurance commissioner does—busying herself elsewhere. She's president of the NAIC and, according to her bio, "is active in financial convergence issues, international affairs, and regulatory modernization efforts."

Welcome to the world of "progressive" regulation. ■

The world's most dangerous insurance publication℠

SCHIFF'S
INSURANCE OBSERVER

Editor and Writer . . . . David Schiff
Production Editor . . . . Bill Lauck
Foreign Correspondent . . Isaac Schwartz
Copy Editor . . . . John Cauman
Publisher . . . . Alan Zimmerman
Subscription Manager . . . . . . Pat LaBua

Editorial Office
Schiff's Insurance Observer
300 Central Park West, Suite 4H
New York, NY 10024
Phone: (212) 724-2000
Fax: (212) 712-1999
E-mail: David@InsuranceObserver.com

Publishing Headquarters
Schiff's Insurance Observer
SNL c/o Insurance Communications Co.
321 East Main Street
P.O. Box 2056
Charlottesville, VA 22902
Phone: (434) 977-5877
Fax: (434) 984-8020
E-mail: Subscriptions@InsuranceObserver.com

Annual subscriptions are $149.
For questions regarding subscriptions please call (434) 977-5877.

Reprints and additional issues are available from our publishing headquarters.
Insurance Communications Co. (ICC) is controlled by Schiff Publishing. SNL Financial LC is a research and publishing company that focuses on banks, thrifts, real estate investment companies, insurance companies, energy and specialized financial-services companies. SNL is a nonvoting stockholder in ICC and provides publishing services to it.