

## **“Preventing Capture Through Consumer Empowerment Programs: Some Evidence from Insurance Regulation”**

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### Abstract

This Chapter in *Preventing Capture: Special Interest Influence in Regulation and How to Limit It*, examines the extent to which consumer empowerment programs can counteract industry influence over insurance regulation. Consumer empowerment programs come in two basic varieties. Proxy advocacy creates independent government entities that are tasked with representing consumer interests in regulatory processes, while tripartism empowers independent public interest groups to influence regulation. Focusing on three short case studies, the Chapter offers several preliminary thoughts regarding the optimal deployment and design of these programs in insurance regulation. First, it suggests that proxy advocacy can effectively counteract industry influence where there exists a discernible consumer position, new information is likely to impact regulatory results, and the involvement of non-industry stakeholders is limited. These conditions are met in a broader set of circumstances than the current deployment of proxy advocacy might suggest. Second, it argues that tripartism may be more desirable than proxy advocacy when a clear consumer position is difficult to identify or the threat of political pressure is an important tool to influence results. However, the Chapter cautions that tripartism may be ineffective where there does not exist a sufficient network of public interest groups, which is a substantial risk in regulatory contexts that resemble insurance.

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## Introduction

In many regulatory settings, individuals face a collective action problem in advocating for their preferred outcomes, whereas regulated entities can coordinate to overcome free rider problems. (Stigler, 1971). The resulting imbalance in participation can, in some cases, produce outcomes that are “consistently or repeatedly directed away from a defensible model of the public interest toward the interest of the regulated industry.” (Moss & Carpenter, 2011). In the classic story, such regulatory capture occurs through industry payment of rents to regulators, including explicit bribes, promises of future employment, or political contributions. But more recent literature emphasizes that one-sided participation in regulation can also produce capture through cultural and behavioral forces. (Kwak, 2011; Schwarcz & McDonnell, 2011). Similarly, industry-dominated participation in regulatory processes may generate “information capture,” by which industry exerts substantial control over regulatory outcomes by producing “uncontrolled and excessive” amounts of information. (Wagner, 2010).

In recent years, academic interest in limiting these forms of regulatory capture has skyrocketed. (Barkow, 2010; Bagley, 2010; McDonnell & Schwarcz, 2011; Miller & Rosenfeld, 2009; Wagner, 2010). But the question of how best to prevent regulatory capture has a long and distinguished pedigree. (Novak, 2011). One approach to preventing capture that has gained some traction in recent decades is the creation of consumer empowerment programs that directly enhance the capacity of consumer representatives to participate in regulatory processes. These programs come in two basic varieties. First, proxy advocacy relies on independent government entities that are tasked with representing the public interest in designated regulatory proceedings. These

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programs became particularly prominent in state regulation of utility rates during the 1970s and 80s. (Holburn & Spiller, 2002). Alternatively, tripartite consumer empowerment programs seek to amplify the voice of non-government public interest groups that would ordinarily be under-represented in the regulatory fray. (Ayres & Braithwaite, 1992). Examples include statutorily-required consumer advisory panels for regulators and programs that reimburse consumer groups for the cost of participating in regulatory proceedings.

This Chapter examines consumer empowerment programs in insurance regulation. Insurance regulation is an important, and heretofore largely neglected, context in which consumer empowerment programs have evolved to limit the perceived risk of regulatory capture. Unlike virtually any other regulatory domain, dramatically different types of consumer empowerment programs have been implemented in insurance regulation in the last several decades. This allows for comparison of different consumer empowerment programs within similar regulatory contexts. Additionally, insurance regulation is conducted primarily at the state level, where regulatory capture can operate through distinctive mechanisms that pose particularized opportunities and challenges. (Revesz, 2001).

Three consumer empowerment programs have gained significant traction in insurance regulation. First, the Texas Office of Public Insurance Counsel (“OPIC”) is a classic proxy advocate that is tasked with a broad range of responsibilities in insurance regulation. Second, the California Public Participation Plan (“CPPP”) largely mirrors OPIC in its scope, but is more consistent with the tripartism model. CPPP reimburses the expenses of designated public interest groups who make a “substantial contribution” to certain regulatory proceedings. Finally, the

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National Association of Insurance Commissioners' (NAIC) Consumer Participation Program represents a very different model of tripartism. It provides approximately twenty-five selected consumer representatives with limited reimbursement of expenses, research assistance, free access to public documents, training, designated public fora to present on issues of their choosing, and privileged access to regulators.

This Chapter compares and evaluates these three consumer empowerment programs. Integrating these case studies with preexisting literature, it also offers several tentative observations about when consumer empowerment programs might help offset, limit, or supplement industry influence in insurance regulation and similar regulatory settings, such as state securities and banking regulation. First, it suggests that proxy advocacy is most effective when there is a clear consumer position, new information is likely to impact regulatory results, and the involvement of non-industry stakeholders is limited. These conditions are met in a broader set of circumstances than the current deployment of proxy advocacy might suggest. Second, it argues that tripartism may be more desirable than proxy advocacy when a clear consumer position is difficult to identify or the threat of political pressure is an important tool to influence results. However, in the absence of a robust network of public interest groups, effective tripartism may be difficult. Both for this reason and because proxy advocacy enjoys some comparative advantages to tripartism, the Chapter concludes by suggesting that it may sometimes be appropriate to deploy both forms of consumer empowerment.

Importantly, this Chapter's focus is on the use of consumer empowerment programs to counteract industry influence in insurance regulation. Of course, not all industry influence of

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regulation amounts to capture. (Carpenter, 2004). But because other entries in this Volume focus on diagnosing capture, this Chapter side-steps the question of when industry influence is indicative of capture. The Chapter therefore does not consider the extent to which the underlying forms of insurance regulation discussed below are themselves socially desirable, except insofar as that issue bears on the influence of consumer empowerment programs.

### **A Brief History of Consumer Empowerment Programs**

The public has long enjoyed the capacity to participate in regulatory rulemakings through notice and comment. In many cases, though, this participation is dominated by regulated entities with similar, self-interested, perspectives. (Wagner, 2010; Yackee & Yackee, 2006). Public involvement in regulatory processes other than rule-makings is often even more limited. Even in proceedings that are ostensibly open to the public, such as certain rate-setting and licensing hearings, the public may lack the expertise to participate. (Mayer et al, 1989). And for many types of regulatory activities, members of the public have few, if any, formal mechanisms of influence.

Seeking to enhance consumer and citizen influence over regulation, reformers in the 1970s proposed creating government entities that would operate as a proxy for the public in certain regulatory proceedings. These proxy advocates can take various forms, including (i) independent consumer counsels/advocates, (ii) designated divisions within an attorney general office, or (iii) specialized staff housed within a regulator. (Mayer et al, 1989). Proxy advocacy became particularly prominent in state regulation of public utility rates during the 1970s and 80s. (Holburn & Spiller, 2002).

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Consistent evidence suggests that proxy advocacy in utilities regulation helps counteract industry influence. It results in a lower percentage of rate increase requests being granted, a decreased likelihood that utilities will seek to increase rates in the first place, and overall decreased rates. (Berry, 1984; Holburn & Spiller, 2002). The effects are strongest when proxy advocates are structured as an independent consumer counsel rather than designated staff within a regulator or specialized division within an attorney general office. (Mayer et al, 1989). However, findings are mixed about the extent to which these benefits are evenly distributed among consumers. (Gormley, 1981; Holburn & Spiller, 2002). Proxy advocates wield their influence primarily by providing information and a consumer perspective to an Administrative Law Judge (ALJ) in technical rate-setting hearings, or negotiating settlements in connection with those hearings. (Holburn & Spiller, 2002; Littlechild, 2009). Unlike public interest groups, proxy advocates rarely emphasize the application of political pressure in describing their influence. (Gormley, 1983).

In the 1980s and 90s, tripartism emerged as an alternative form of consumer empowerment. Rather than creating a single government defender of the public interest, tripartism formally involves independent public interest groups in regulatory proceedings. Its developers, Ian Ayres and John Braithwaite, advance a quite specific vision of tripartism: empowered public interest groups – whom they saddle with the unfortunate acronym “PIGs” – must be fully informed regarding regulatory issues, allowed to participate in the negotiation of regulatory outcomes, and permitted to challenge industry behavior through the same mechanisms as the regulator. Additionally, the role of empowered PIG must be contestable, such that alternative PIGs can become empowered. So conceived, tripartism can counteract regulatory capture through both

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economic and cultural forces, according to Ayres and Braithwaite. From an economic perspective, empowered PIGs can increase the cost to firms of securing regulatory compliance, effectively requiring industry to expend resources to capture two separate groups. Although PIGs may be subject to capture, this risk is limited both by their self-identification and the contestability of their position. From a sociological perspective, tripartism can promote a spirit of “regulatory communitarianism” among regulators, industry, and empowered PIGS, thus modifying “the deliberative habits and behavioral dispositions of actors” to promote mutually beneficial results. (Ayres & Braithwaite, 1989).

In recent years, lawmakers have experimented with cooperative and participatory approaches to regulation that incorporate features of tripartism. (Lobel, 2004; Karkkainen, 2004; Dorf & Sabel, 1998). However, these experiments in “new governance” vary substantially in the extent to which they *affirmatively empower* PIGs relative to other stakeholders in order to prevent undue industry influence. (Fung & Wright, 2003). Some critiques of new governance programs nonetheless provide helpful guidance for implementing effective tripartism. For instance, Mark Seidenfeld argues that empowered PIGs may be co-opted by other stakeholders if they are repeatedly involved in regulatory negotiations. He therefore suggests that government must “establish internal [PIG] mechanisms that ensure group leaders’ accountability to putative beneficiaries of regulation...” (Seidenfeld, 2000). Empirical studies of tripartite structures deployed outside of new governance contexts are limited. However, one detailed study of a program at the Consumer Safety Product Commission that reimbursed non-industry participation in notice and comment rulemaking offered mixed praise: while reimbursed involvement often meaningfully

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contributed to and impacted regulatory results, the program routinely failed to provide funding in the contexts where it would be most impactful. (Tobias, 1986).

### **Three Consumer-Empowerment Models in Insurance Regulation**

Although the political economy of insurance regulation is both complex and contingent, most observers agree that the insurance industry often enjoys substantial influence over regulatory outcomes. (Meier, 1988; Randall, 1999; Schwarcz, 2009). In response, several states have implemented consumer empowerment programs designed to counteract insurer influence. Three of these have gained significant traction.<sup>1</sup> The first, the Texas Office of Public Insurance Counsel, is a classic proxy advocate that was originally modeled on proxy advocacy in public utilities regulation. The second, the California Public Participation Program, is an experiment in tripartism that comes relatively close to meeting the criteria developed by Ayres and Braithwaite. Finally, while the NAIC Consumer Participation Program is also an experiment in tripartism, it fits less neatly into the formal Ayres/Braithwaite framework. Table Four, at the conclusion of this sub-section, summarizes some key features of each consumer empowerment program.

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<sup>1</sup> The only other major consumer empowerment program in insurance is the Florida Insurance Consumer Advocate. This program was not studied because it is not independent, but reports directly to Florida's Chief Financial Officer. Other consumer-oriented insurance offices exist in various states, including Louisiana, Vermont, Maryland, New Jersey and Ohio. But all of these offices operate exclusively or almost exclusively to help resolve consumer complaints, and do not therefore constitute "consumer empowerment programs" as that term is used herein. Finally, while Michigan briefly established by executive order the position of Automobile and Home Insurance Advocate, a new Governor abolished that office three years after its creation.

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## 1. The Texas Office of Public Insurance Counsel

The Office of Public Insurance Counsel (OPIC) is an independent agency in Texas that is charged with representing Texas insurance consumers.<sup>2</sup> OPIC is formally independent of the Texas Department of Insurance (TDI) and has no regulatory authority. Its 16 employees include attorneys, an economist, statisticians, researchers, and support staff. The Public Counsel, who directs OPIC, is appointed by the Governor and confirmed by the Senate to a two-year term. The agency's funding, which amounts to slightly over a million dollars a year, comes directly from insurance companies, who pay an annual assessment of approximately 6 cents for each policy in force during the calendar year.

Established in 1991, OPIC's original structure was similar to that of proxy advocates in utilities regulation. At that time, Texas utilized a strict version of rate regulation wherein TDI set a range of acceptable rates and companies wishing to deviate from this range were required to seek prior approval. OPIC's primary responsibility was to represent consumers in hearings setting benchmark rates and considering company requests for deviations. OPIC's role in other arenas was limited, although it did push some regulatory initiatives, such as banning the use of prior insurance as an underwriting guideline. Notably, Texas required homeowners insurers to use one of three state-promulgated insurance policies at the time of OPIC's establishment, thus limiting OPIC's

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<sup>2</sup> The statutory framework for OPIC is See Tex. Ins. Code Ann. § 501, et seq., available at <http://codes.lp.findlaw.com/txstatutes/IN/5/A/501/C>. The descriptive information about OPIC in this section is derived from OPIC's self-evaluation reports, operating budgets, and strategic plans, which are all available on OPIC's website at [www.opic.state.tx.us](http://www.opic.state.tx.us).

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involvement in form regulation.<sup>3</sup>

In 2003, however, Texas loosened its regulation of personal lines of insurance. First, with respect to core personal lines of coverage, it moved from a benchmark method of rate regulation to a file and use scheme. Under this approach, insurers are permitted to set their rates without prior approval from TDI and need only adjust if TDI affirmatively finds the rating plan to be “excessive, inadequate, or unfairly discriminatory.”<sup>4</sup> Second, Texas substantially deregulated homeowners policy forms in 2003. Carriers now have free reign to design their policy forms, though these forms cannot be used without TDI’s prior approval. TDI is authorized to disapprove a policy form if it “violates any law ... is unjust or deceptive, encourages misrepresentation, or violates public policy.”<sup>5</sup>

These changes in regulation altered OPIC’s primary responsibilities. Although OPIC continues to represent consumers in benchmark rate hearings (which persist in certain policy lines, such as credit and title insurance), its primary responsibility is now to review companies’ rate and form filings. If it has concerns about these filings, it can request additional information from the insurer or file an objection to TDI. TDI is not required to hold a hearing in response to an OPIC objection, and any hearings it does hold must be within 30 days of the petition filing date. Throughout the filing process, OPIC may informally negotiate with the filing insurer and/or TDI to

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<sup>3</sup> OPIC was nonetheless involved in evaluating proposals from industry to change the forms or use optional endorsements to change coverage.

<sup>4</sup> Tex. Ins. Code § 2251.051 (2010)

<sup>5</sup> Tex. Ins. Code § 2301.007 (2010)

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resolve its concerns.

OPIC also plays a role in TDI rulemaking and the provision of consumer information. OPIC evaluates rules before they are formally proposed and may informally submit comments to TDI. Once TDI publishes a rule for public comment, OPIC may participate in the same manner as any other stakeholder. Additionally, OPIC is statutorily empowered to recommend rule changes or legislative enactments. OPIC is also heavily involved in providing consumer information. In recent years, statutes have required OPIC to provide consumer report cards on Health Maintenance Organizations, a consumer bill of rights for personal lines of insurance, and a website that helps consumers understand the difference between different companies' policy forms.

Evaluations of OPIC's contributions to Texas insurance regulation are mixed. In 2008, a staff report to the Texas Sunset Advisory Commission – a legislative body that regularly reviews agencies to assess the continued need for their operations – recommended abolishing OPIC and replacing it with a consumer representative within TDI.<sup>6</sup> The report argued that OPIC's activities largely mirrored those of TDI, but were less effective because OPIC did not have any regulatory authority. It also suggested that OPIC was not regularly included in conversations and negotiations between TDI and insurers.

Various commentators, however, objected to this proposal.<sup>7</sup> Of particular note, TDI

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<sup>6</sup> Sunset Advisory Commission, Final Report, Texas Department of Insurance & Office of Public Insurance Counsel 110 (July 2009), available at [http://www.sunset.state.tx.us/81streports/tdi/tdi\\_opic\\_fr.pdf](http://www.sunset.state.tx.us/81streports/tdi/tdi_opic_fr.pdf).

<sup>7</sup> Comments submitted on OPIC in 2008 are available through the sunset commission's website (<http://www.sunset.state.tx.us/81streports/tdi/responses/chart.htm>). The 2010 testimony

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“strongly urge[d]” the legislature to maintain OPIC “as a separate state agency,” arguing that “[a]n independent consumer advocate, [it] has benefited Texans by providing perspectives and input that enriches the regulatory system.” OPIC itself argued that “the most effective approach to providing consumer representation is to ensure that such representation is independent ... [and] free from any limitations of the Commissioner's previous decisions and current views.” Ultimately, the Commission soundly rejected the report’s recommendation, concluding that “the independence provided by being a separate, stand-alone agency was important and outweighed any potential benefits of changing the Office’s structure.” The state legislature continued OPIC for two years, but asked the Commission to revisit the issue at that time. In February, 2011 the Commission again concluded that “the state has a continuing need for” OPIC.

The regular activities of OPIC in the last three available years are documented in Table One, which is based on OPIC’s annual (and occasionally audited) performance measures.

**Table One: OPIC’s Recent Activities<sup>8</sup>**

YEAR:	2007	2008	2009
Rate filings analyzed	761	805	706
Rate filings in which OPIC participated	32	32	52
Form filings analyzed	321	411	514

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revisiting this issue is also available at <http://www.sunset.state.tx.us/82ndreports/tdi/responses/chart.htm>.

<sup>8</sup> These statistics are derived from yearly “agency at a glance” summaries of OPIC available on the Sunset Commission’s website.

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Form filings in which OPIC participated	24	15	36
Proposed rules analyzed	89	110	51
Proposed Rules in which OPIC participated	16	35	16
Contested and industry-wide rate hearings	5	4	5

Notably, OPIC’s participation need not be extensive in order to be counted as participation for purposes of these statistics. Participation includes any “participation in settlement negotiations or pre-hearing matters during the reporting period” as well as “discussions or negotiations prior to postings or hearings that may result in the agency’s recommendation being incorporated into the proposal prior to publication, or which eliminates the need for a hearing.”<sup>9</sup> The Sunset Report provides more detailed information on the scope of OPIC’s participation. OPIC participated in 32 rate filings in 2007. Of these, it simply requested additional information in 10 cases and filed formal objections to TDI in the other 22 cases. In half the cases where OPIC formally objected, TDI did not take any action in response to OPIC’s objection. OPIC enjoyed more success with respect to form filings in 2007, successfully negotiating, without resort to formal objection, settlements in 22 of the 24 form filings in which it participated. Finally, in the 16 instances where it participated in rule proposals, it informally worked on a rule four times, filed formal written comments four times, and testified at eight rule making hearings.

Recent OPIC promotional materials claim that the agency’s 19 most significant rate cases since 2009 have produced consumer savings of \$330 million, and \$545 million if cases under

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<sup>9</sup> This definition is not available online, but was provided in response to a public records request from Texas’s Automated Budget and Evaluation System of Texas.

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appeal are included.<sup>10</sup> However, this statistic conflates various types of proceedings, and credits OPIC alone for any savings arising from proceedings in which it participated. About \$260 million (or \$365 million if cases under appeal are included) of these savings stem from required, industry wide rate hearings that would have occurred even without OPIC's involvement. Although OPIC's testimony and evidence may have increased the total amount of consumer savings, most of these savings would presumably have occurred even without OPIC's participation.

In most of the remaining cases, estimated savings are based on rate reductions or disallowances that occurred after OPIC objected to a filing. Collectively, these cases produced savings amounting to between \$70 and \$180 million. Of course, TDI might well have challenged these filings without OPIC's initial objection. But OPIC deserves substantial credit for rate reductions in these cases given its role in initiating the challenge. Perhaps the most important case, which is currently on appeal, involves a long-standing dispute between TDI and State Farm Lloyds regarding the extent of a company overcharge of its policyholders. In calculating the amount of the alleged overcharge, TDI staff suggested that refunds should be paid through June 2006, whereas OPIC argued that this rebate period should extend through August 2008. The insurance commissioner ultimately adopted OPIC's suggestion, resulting in \$110 million in additional projected policyholder refunds. As the Public Counsel credibly claimed in this case, "[t]his would not have occurred but for OPIC's role in this litigation."<sup>11</sup>

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<sup>10</sup> These materials were distributed to various policy makers but do not appear to be available online. All such materials are available from the author upon request.

<sup>11</sup> See OPIC's Role in State Farm Case Results in \$110 Million Dollar increase in Ordered Refunds, available at <http://www.opic.state.tx.us/homeowner.php>.

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OPIC's own promotional materials also provide some information about its recent activities in form and rule regulation. Since 2009, OPIC claims credit for prompting change in 87 policy forms. Examples include policies that required consumers to purchase uninsured/underinsured motorist (UIM) coverage and submit to mandatory binding arbitration. These claims are much less contestable than OPIC's purported savings to consumers, given the Sunset Report's finding that companies and TDI were willing to negotiate to resolve OPIC's concerns regarding policies in 22 of 24 cases. OPIC's impact on rulemaking is harder to quantify. But examples of rulemakings in which OPIC has been actively involved include disclosures regarding the scope of coverage and rules governing insurer underwriting. In at least one instance, OPIC seems to have been the driving force for a rule change that reduced the time within which health plans must respond to requests for verification of health coverage from 15 to 5 days.

OPIC has rarely invoked its authority to propose new rules, though it has used this authority more frequently in recent years under the current Public Counsel. In the most important such instance, OPIC proposed and successfully lobbied for the prohibition of discretionary clauses in health, life, and disability insurance policies. These clauses purport to reserve to the insurer or plan administrator discretion whether or not to pay a claim, limiting any judicial review to a determination of whether that decision was arbitrary or capricious.<sup>12</sup> Additional recent rule-making initiatives of OPIC include a rule intended to clarify consumer understanding of title insurance and a bulletin informing consumers that it is unlawful to require consumers to purchase specific amounts

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<sup>12</sup> These clauses are commonly contained in employee-benefit plans. Caselaw suggests that a state ban on discretionary clauses in insurance policies is not preempted by ERISA. See *Am. Council of Life Insurers v. Ross*, 558 F.3d 600 (6th Cir. 2009).

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of UIM insurance.

## 2. California's Public Participation Program

In 1988, California approved by referendum Proposition 103, which broadly reformed the state's regulation of rates in personal lines of insurance, particularly auto insurance. Proposition 103 establishes a consumer empowerment program that has many features of tripartism. The California Public Participation Plan ("CPPP") authorizes consumers and consumer organizations to "initiate or intervene in any proceeding permitted or established" by the insurance code governing rates, as well as to "challenge any action... and enforce any provision" of Proposition 103. Even more importantly, it provides for the reimbursement of such parties if they "make a substantial contribution to the adoption of any order, regulation or decision by the commissioner or a court."<sup>13</sup> Reimbursement includes "reasonable" attorney fees, witness fees, and costs, which has been interpreted to equal the rates that industry pays. In recent years, these rates range up to over \$500 an hour for certain attorneys and \$300 an hour for certain actuaries. However, there is often a substantial time gap in the payment of this compensation: intervenors typically receive compensation about 2.5 years after they provide the underlying services.<sup>14</sup>

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<sup>13</sup> Cal. Ins. Code § 1861.05. Basic information about CPPP is available from CDI's website, <http://www.insurance.ca.gov/0100-consumers/0300-public-programs/0300-public-participation/>. A CDI informational report on the program is also available online: <http://www.insurance.ca.gov/0250-insurers/0300-insurers/0200-bulletins/prop-103-recoup/report-on-intervenor-program.cfm>.

<sup>14</sup> These statistics as well as subsequent information in this section are derived from analysis of all documentation pertaining to requests for intervenor compensation in 2009 and 2010, including intervenors' requests for compensation, any motions in opposition filed by insurers,

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The CPPP process differs depending on whether it involves a specific company's rate filing or another regulatory matter. Companies seeking to change premiums for specified policy lines must first receive prior approval from the California Department of Insurance ("CDI"). To do so, they file an electronic rate change application, which is posted online. Potential intervenors can review these online applications and petition CDI for a hearing on any specific application. CDI must issue written findings if it declines a hearing request and it cannot decline a request if the proposed rate change exceeds 7% for a personal line. After the underlying application is resolved, the intervenor can seek a reimbursement order from CDI by demonstrating that its participation "resulted in more relevant, credible, and non-frivolous information being available to the Commissioner."<sup>15</sup> Intervenors can seek reimbursement for participation in settlement negotiations, even in the absence of a formal hearing. Intervenors' costs are paid by the insurer seeking a rate increase. Interventions that do not involve specific rate filings typically occur in the same manner as ordinary participation in administrative processes: notice and comment rulemaking and judicial review. As above, however, intervenors can subsequently apply for compensation if they make a substantial contribution, though compensation is paid out of a specially designated fund to which all insurers contribute.

Table two reports basic information about the program's operation from 1993 to 2010,

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final decisions of CDI with respect to these requests, and any underlying ALJ decisions in such cases. These documents were acquired from CDI through the author's public records requests and are available from the author upon request.

<sup>15</sup> California Department of Insurance, Public Participation Plan, <http://www.insurance.ca.gov/0100-consumers/0300-public-programs/0300-public-participation/>.

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based on internal CDI records.<sup>16</sup> In examining these data, it is helpful to bear in mind that non-rate disputes frequently triggered interventions by multiple groups whereas rate disputes often involved a single intervenor.

**Table Two: Historical Experience of CPPP**

YEAR	Compensation Grants	Compensation Grants involving Rate Interventions	Total Compensation Awarded	Number of separate intervening parties	Number of separate parties in rate interventions
1993	17	4	\$793,371.00	6	4
1994	8	3	\$957,289.41	6	2
1995	17	6	\$1,295,761.99	7	3
1996	17	6	\$645,044.98	7	2
1997	10	0	\$198,389.29	5	0
1998	8	2	\$482,724.82	4	1
1999	5	3	\$379,087.83	2	1
2000	3	2	\$540,662.59	3	2
2001	2	0	\$496,299.18	1	1
2002	3	0	\$482,457.87	2	0
2003	9	4	\$480,750.00	5	3
2004	9	4	\$775,824.00	4	3
2005	6	1	\$915,040.00	4	1

<sup>16</sup> Information dating back to 2003 is available at, <http://www.insurance.ca.gov/0250-insurers/0300-insurers/0200-bulletins/prop-103-recoup/index.cfm>. Information prior to that time was obtained from CDI through a public records request.

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2006	18	8	\$2,522,252.00	7	1
2007	10	4	\$1,218,829.00	4	2
2008	7	3	\$731,341.00	1	1
2009	5	5	\$2,473,359.00	1	1
2010	6	5	\$981,776.00	1	1

The years between 1996 and 2001 are shaded to reflect compensation granted for actions filed during the time that Charles Quackenbush was commissioner.<sup>17</sup> Consumer groups labeled Quackenbush “anti-consumer,” and he eventually resigned in the face of allegations that he settled investigations of insurer misconduct on terms favorable to the industry in exchange for funding of his political advertisements. The data show that the number of intervenor proceedings, the total amount of compensation money granted, and the average amount of compensation money granted all dipped to their lowest point while Quackenbush-era interventions wended their way through the system.

As Table Two shows, CPPP’s success in inducing broad participation from public interest groups has been mixed. Until about 2004, a diverse range of organizations intervened in rulemaking and rate hearings, including organizations like the Southern Christian Leadership Conference, Public Advocates Group, Consumer Union, Voter Revolt, and a handful of private citizens and attorneys. In recent years, however, a single organization – Consumer Watchdog (“CW”) – has become the sole significant user of the intervention process, particularly with respect to rate

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<sup>17</sup> Roughly speaking, actions filed during Quackenbush’s tenure were compensated between the years of 1996 and 2001, even though his actual term ran from 1995 to 2000.

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hearings. In fact, CW is the sole recipient of forty-two of the sixty-six awards made since 2003, and the only organization to receive any reimbursement since 2007. During that period, CW is also, with a single exception, the only party to receive compensation for intervening in rate applications.

In the last two years, eleven requests for intervenor compensation were filed – ten for rate proceedings and one for administrative rule-making. All of these requests were filed by CW and all resulted in the payment of some compensation, which totaled \$3,266,806. Table three summarizes CW’s interventions in the ten rate hearings during this timeframe.

**Table Three: Rate proceedings in which compensation was awarded, 2009-2010**

Insurer	Hearing Granted?	Requested Rate Change	Final Rate	Difference
Allstate	Yes	12.20%	-28.80%	-41.00%
Allstate	Yes	-7.10%	-15.90%	-8.80%
Fireman’s	Settlement	-5.60%	-17.90%	-12.30%
Geo Vera	Settlement	6.80%	0%	-6.80%
Explorer	Yes	17.50%	-15%	-32.50%
Topa	Settlement	9.26%	6.90%	-2.36%
Fireman’s	Yes	24.70%	15.28%	-9.42%
State Farm	No	-3.20%	-8%	-4.80%
Progressive	No	6.49%	4.70%	-1.79%
Mid-Century	No	1.50%	0.00%	-1.50%

CW played an instrumental role in initiating challenges to the underlying rate filings in these

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cases. Eight of the ten proceedings began with CW's sole motion for a hearing in response to a proposed rate change, whereas only two were initiated by CDI. CDI typically granted the hearing request or the case settled before a hearing could be held. Even in the three most recent instances – in which CDI denied CW's hearing request – CW participated in extensive negotiations with CDI and the filing insurer, with CDI requesting CW's analysis of proposed rates and inviting it to participate in conference calls with the insurers. In these more recent cases, CDI agreed with some of CW's challenges, but bypassed formal hearings by directly ordering its preferred rate changes.

CW's role was even more significant when CDI granted its request for a hearing. In such cases, CW typically “propounded the bulk of formal discovery and informal requests for documentation.”<sup>18</sup> These requests could produce as many as 10,500 pages of documents. CW was also substantially involved in the ultimate resolutions of these cases. CW participated in most settlement discussions. One typical case described how “between July 2007 and April 2008, the parties engaged in regular discussions, including at least five settlement conferences with [the insurer and CW's] actuaries.”<sup>19</sup> Additionally, CW often took part in three-way negotiations with insurers and CDI. In some cases, CDI seemed to rely upon CW to provide actuarial work and thorough critical analysis of an insurer's proposals.

CW's involvement was clearly responsible for producing decreased rates in at least some instances. For instance, in one intervention, CDI and insurer GeoVera attempted to stipulate a rate

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<sup>18</sup> Decision Awarding Compensation to Foundation for Taxpayer and Consumers Rights Re: Fireman's Fund, PA-2007-00017, at 8 (CA Dep't of Insurance April 6, 2008).

<sup>19</sup> Decision Awarding Compensation Re: Fireman's Fund, PA-2007-00017, at 4.

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increase of 6.8%.<sup>20</sup> An ALJ blocked the proposed settlement after CW contested it. Ultimately, GeoVera entered a second settlement, this time agreeing to not raise its rate at all, and to abandon its proprietary cost and replacement methodology. A few months later, a settlement was negotiated between CDI, CW, and insurer Topa. While awarding CW compensation for that settlement, the Commissioner noted that “virtually every issue raised in [CW’s] petition was discussed with Topa either by the Department . . . or by both parties in subsequent negotiation proceedings.”<sup>21</sup>

CW’s impact on rate filings likely extends beyond the few cases in which it formally intervenes. Informal conversations with various members of both CW and CDI repeatedly suggested that the program has an important deterrent effect on rate filings. According to this theory, carriers initially seek lower rates or refrain from seeking rate increases because they want to avoid triggering a hearing or other type of public challenge. This hypothesis is consistent with empirical findings in the public utilities context that utilities are less likely to initiate rate reviews when monitored by a public consumer advocate. (Holburn & Spiller, 2002). Additionally, even when it opts not to mount an official challenge, CW often informally refers its concerns about insurers and rates to CDI.

The impact of CPPP on rate filings is particularly notable because California has largely escaped many of the adverse consequences normally produced by regulatory efforts to suppress

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<sup>20</sup> Decision Awarding Compensation to Foundation for Taxpayer and Consumer Rights Re: GeoVera, PA-2007-00008, at 12 (CA Dep’t of Insurance Sept. 15, 2009).

<sup>21</sup> Decision Awarding Compensation to Consumer Watchdog Re: Topa, PA-2008-00018, at 11 (CA Dep’t of Insurance Jan. 7, 2010).

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rates.<sup>22</sup> Most economic studies of such regulation are highly critical of the practice. Among other things, they find that price regulation tends to increase the size of involuntary markets, generate subsidies to more risky drivers, exacerbate moral hazard, and decrease the number of competing insurers. (Tennyson, 2007). Rate regulation often does not even accomplish its goal of suppressing rates in the long term, as firms are too reluctant to reduce rates when costs decrease and seek excessive rate increases when politically feasible. (Harrington, 2002). In sharp contrast to these trends, automobile insurance premiums in California have increased at a slower rate since the passage of Proposition 103 than in any other state in the country, primarily as a result of decreases in amounts paid out in claims. (Jaffee & Russell, 2002). Despite these facts, insurer profits remain strong, numerous insurers compete for business, and remarkably few drivers resort to assigned risk pools. To be sure, interpretation of these outcomes is contestable. (Appel, 2002; Rosenfield, 1998). But by limiting insurers' capacity to raise rates during politically favorable moments, the intervenor program may have contributed to California's favorable experience with rate regulation.

In addition to rate filings, CW participated in one rulemaking in the past two years: the promulgation of "Pay As You Drive" ("PAYD") regulations, which allow premium rating based on verified driving data. CW's participation included repeated comments in response to proposed regulations, attendance of public hearings, drafting of proposed amendments, and meetings with CDI staff. Ultimately, CW enjoyed some limited success in shaping the final regulation: in response to CW concerns, complex "Price Per Mile" provisions were stripped out of the regulation

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<sup>22</sup> To be clear, this research is generally focused on efforts to suppress rates through regulation rather than on regulation designed to regulate permissible risk classification. The two forms of rate regulation raise very different issues.

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and limitations were placed on allowable monitoring technology.<sup>23</sup> But many of CW's most vigorous suggestions were not reflected in the final results. For instance, CW argued strenuously in favor of narrow mileage bands, which would allow consumers to reduce their premiums by changing their driving habits. Ultimately, though, CDI stripped out any provision limiting mileage bands. Similarly, CDI resisted CW's suggestions that variation in premiums solely reflect miles driven, which would have prevented insurers from favoring drivers who used electronic mileage verification systems. Tellingly, CW requested compensation for a post-promulgation editorial decrying the final regulations, claiming that it was a "final attempt to influence the Commissioner's actions."

CW has also participated in several important rulemakings prior to the previous two years. One of the most significant involved a prohibition on automobile insurers using ZIP codes to rate policyholders, a practice that some claim discriminates against low-income drivers. Although Proposition 103 prohibited rating on this basis, it was not until 2006 – under the leadership of a self-proclaimed consumer advocate commissioner – that CDI finalized regulations implementing this rule. At that time, insurers launched substantial legal and political challenges to the rule. Eight different intervenors participated in the resulting court battle to defend CDI's implementing regulations.<sup>24</sup> In total, these organizations received approximately \$3.5 million in reimbursement for

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<sup>23</sup> Decision Awarding Compensation to Consumer Watchdog Re: Pay As You Drive, REG-2008-00020, at 3 (CA Dep't of Insurance Nov. 16, 2010); Consumer Watchdog's Request for Compensation Re: Pay As You Drive, REG-2008-00020, Exhibit B, at 1 (Nov. 16, 2009).

<sup>24</sup> Ralph Vartabedian, *Good Driver? Bad Driver? Insurers May Wonder Too*, L.A. Times, Jan. 17, 2007, available at <http://articles.latimes.com/2007/jan/17/autos/hy-wheels17>.

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their efforts.<sup>25</sup>

In virtually all facets of its involvement in California regulation, CW tends to adopt a very aggressive, advocacy-oriented stance. In rate hearings, it often argues in the alternative, advancing multiple competing rationales for a particular rate reduction. In one instance, it identified five distinct problems with the actuarial calculations supporting a single request for higher earthquake premiums. Notably, CDI endorsed none of CW's positions. Even when CDI opposes a particular rate change, CW will usually find a new and separate rationale for opposing the same change – perhaps ensuring that all bases are covered. Although these arguments occasionally succeed, CW's scattershot approach has its costs. ALJs often regard its positions with skepticism – and occasionally, with hostility. For example, one ALJ dismissed the organization's actuarial work as being “without merit,” saying that its arguments were “deficient and not credible.”<sup>26</sup> Another said that CW's testimony “at the least, is careless, and may be dodgier than that.”<sup>27</sup>

Currently, CW is waging a significant political campaign, along with numerous other interests, to extend prior approval rate regulation to California's health insurers. Current versions of the bill would also extend the CPPP model to health insurance, thus allowing CW and other consumer groups to intervene in carriers' rate applications and subsequently apply for

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<sup>25</sup> California Department of Insurance, Informational Report on the CDI Intervenor Program, <http://www.insurance.ca.gov/0250-insurers/0300-insurers/0200-bulletins/prop-103-recoup/report-on-intervenor-program.cfm>.

<sup>26</sup> Order Adopting Proposed Decision & Order Designating Portion as Precedential Re: Allstate, PA 2006-00004, at 1 (CA Dep't of Insurance July 8, 2008).

<sup>27</sup> Commissioner's Order Re: Fireman's Fund, PA 2007-00019, at 49.

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compensation. CW's advocacy for this legislation relies substantially on its experience in the CPPP. As CW states in one press release: implementing rate review along with a consumer intervention process would "save money on health insurance premiums" because "since 2003, our nonprofit organization has challenged the proposed rates of nearly 30 auto, home, and medical malpractice insurance companies in California, and these challenges have saved Californians over two billion dollars."<sup>28</sup>

### 3. The NAIC Consumer Participation Program

In 1992, the NAIC created a Consumer Participation Program to amplify the consumer perspective in all phases of NAIC activities and deliberations.<sup>29</sup> The NAIC is a voluntary association of state insurance regulators. Although it is not itself a regulator, the NAIC wields tremendous influence through activities such as drafting model laws and regulations, coordinating enforcement actions and investigations, and developing best practices. Like CPPP, the NAIC Program is fundamentally an experiment in tripartism: it empowers existing consumer organizations and individuals to participate in the NAIC's processes. In recent years, between twenty and thirty individuals are selected to be consumer representatives by a board of commissioners and long-time

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<sup>28</sup> Doug Heller, *Intervenor System Has Worked To Save California Insurance Customers \$2 Billion Since 2003* (5/12/2011), available at <http://www.consumerwatchdog.org/blog/intervenor-system-has-worked-save-california-insurance-customers-2-billion-2003>.

<sup>29</sup> Basic Information about the NAIC consumer representative program is available through the NAIC website, at [www.naic.org](http://www.naic.org). However, much of the information in this section is based on the author's experiences serving as a consumer representative for the last four years.

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consumer representatives.<sup>30</sup> These representatives are typically academics or employees of public interest organizations. Their tenure as consumer representatives ranges from a single year to over a decade.<sup>31</sup> The author is currently a consumer representative and has held that position for the last four years.

The Consumer Participation Program takes several approaches to empowering selected consumer representatives to participate in, and influence, NAIC activities. First, consumer representatives are reimbursed from the NAIC's operating budget for expenses (such as plane tickets and hotel rooms) they incur to participate in the NAIC's proceedings.<sup>32</sup> However, unlike CPPP, the program does not compensate consumer representatives for their time. Second, NAIC consumer representatives are provided a designated forum at each NAIC meeting to present on issues of their choosing. Third, consumer representatives enjoy privileged access to regulators: they use regulator facilities at meetings and frequently consult informally with regulators about NAIC issues outside of meetings. Finally, designated NAIC consumer representatives enjoy certain reputational benefits: they are more likely to be sought out by media, asked for their guidance by regulators, and offered opportunities to present at meetings. (Goldsmith, 2005).

These approaches to empowering consumer representatives must be understood within the

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<sup>30</sup> In prior years, the number of consumer representatives has been smaller, closer to between 12 to 16 representatives. (Goldsmith, 2005).

<sup>31</sup> See 2010 NAIC FUNDED CONSUMER REPRESENTATIVES list, available at [http://www.naic.org/consumer\\_participation.htm](http://www.naic.org/consumer_participation.htm).

<sup>32</sup> Several consumer representatives are unfunded, because their organizations have sufficient resources to pay for their expenses.

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distinctive context of the NAIC's processes. The vast majority of the NAIC's work is conducted publicly through conference calls, email list-serves, and meetings that are run by regulators and their staff, but open to broad stakeholder participation. (Jost, 2011). In this sense, at least, the NAIC operates within a new governance regulatory paradigm. The NAIC consumer participation program thus allows for the involvement of empowered consumers in virtually every facet of its operations, including developing "charges" for committees, assessing the need for regulatory intervention, and, most importantly, drafting written work product ranging from model laws to white papers to bulletins to consumer disclosures.

Unlike either CPPP or OPIC, the roles of NAIC consumer representatives are malleable and ambiguous. Aside from attending tri-annual meetings, little is affirmatively required of consumer representatives. Different consumer representatives focus on different issues, ranging from implementation of health insurance reform to the development of consumer disclosures to solvency regulation. Since the passage of the Patient Protection Affordable Care Act (ACA) – which delegates substantial responsibilities to the NAIC – the interests of consumer representatives has been skewed substantially towards health insurance: roughly 17 out of 27 consumer representatives currently focus predominantly on health insurance. By contrast, there is not a single consumer representative whose primary focus involves life insurance or solvency regulation.

The amorphous responsibilities of consumer representatives complicate evaluation of the NAIC consumer participation program. The program has enjoyed some limited success cultivating the active engagement of consumer representatives in NAIC processes. On one hand, many consumer representatives spend a substantial percentage of their work time (often between 5% to

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40%) on NAIC activities. Although they are tremendously outnumbered by industry representatives, they tend to be much more assertive in their participation, at least on certain issues: they literally sit in the front row of meetings, and tend to offer their thoughts more frequently than industry representatives during meetings and conference calls. On the other hand, this participation only extends to a subset of the NAIC's activities, and industry representatives often dominate meetings involving low-profile regulatory issues.

Where a critical mass of consumer representatives has been actively engaged in specific NAIC issues, they have often enjoyed substantial influence in counteracting industry influence. This is clearest in the post-ACA health insurance domain. Perhaps the most notable example involved the NAIC's development of the Medical Loss Ratio (MLR) regulation. Under the ACA, insurers are required to spend a set percentage of premiums improving policyholders' health. The ACA delegates to the NAIC the task of defining what expenditures qualify as meeting this requirement. Despite enormous industry pressure, the NAIC adopted a relatively strict approach that has infuriated various industry groups, particularly insurance agents. The NAIC consumer representatives undoubtedly played a substantial role in producing this result: the 17 health representatives coordinated their efforts to leverage prominent media outlets, individually lobbied commissioners, submitted comments on work products, followed and participated on conference calls, testified in hearings, and provided technical expertise. Many health representatives effectively devoted all or most of their work time to these activities, as their job descriptions aligned precisely with their roles as NAIC consumer representatives. A recent article by Timothy Jost, law professor and NAIC consumer representative, describes other areas where consumer representatives

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influenced NAIC implementation of the ACA. These range from standardized consumer disclosures, to model regulations for health insurance exchanges, to the regulation of rate review. (Jost, 2011).

By contrast, the program has struggled to counteract industry pressure when an issue is not policed by a sufficient number of qualified, interested consumer representatives (although it has done much good in these domains when industry resistance is limited).<sup>33</sup> For instance, consumer representatives have enjoyed only limited success in advocating for enhanced transparency in property/casualty and life insurance contexts. Examples include unsuccessful efforts to (i) make insurer-specific data regarding market conduct and claims handling available to the public; (ii) make filings to the Interstate Insurance Product Regulation Commission public upon submission to allow for public comment; and (iii) collect and publish geo-coded, insurer-specific application, premium, exposure and claims data, similar to the data required of mortgage holders by the Home Mortgage Disclosure Act. In each case, a small handful of consumer representatives devoted attention to the issue through both normal NAIC channels and the attempted application of political pressure through the media. For most (if not all) of these representatives, their efforts were tangential to their primary job responsibilities, and thus the amount of time and effort they could devote to the issue was limited. Ultimately, each of these efforts floundered in the face of overwhelming industry

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<sup>33</sup> For instance, NAIC representatives have done important work enhancing the quality of consumer information provided by regulators by developing better buyers' guides for various insurance lines and improving the usability of their websites.

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opposition.<sup>34</sup>

Perhaps even more distressing than the numerous failed consumer representative initiatives is the near absence of any consumer participation involvement on a broad range of issues that the NAIC regularly encounters. This is particularly notable in the realm of solvency regulation: although assuring insurers' solvency is undoubtedly the principal purpose of insurance regulation, consumer participants have virtually no collective expertise in this area and the vast majority of meetings and initiatives in this domain involve essentially no participation from consumer representatives. The absence of meaningful consumer participation is also notable in various more obscure fields, such as crop insurance and risk retention groups.

Interviews with current and former consumer representatives reflect these failures and emphasize the need for resources to compete with industry in these domains. Birny Birnbaum, Executive Director of the Center for Economic Justice and longtime consumer representative, recently resigned in frustration. He noted that "I've noticed a real sea change in terms of the sort of responsiveness to insurer issues and a lack of responsiveness to consumer issues" and "We just don't have the resources to put the full-court press on the regulators." (Thomas, 2010).

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<sup>34</sup> Recently, NAIC consumer representatives have adopted a new initiative to enhance the transparency of insurance policy terms in personal lines markets. Although still in its infancy, this effort seems to have gained some traction. (Schwarcz, 2011).

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**Table Four: Summary of Consumer Empowerment Programs in Insurance**

	Type of program	Funding Amount	Funding Source	Regulatory Domain	Procedural Rights
<b>OPIC</b>	Proxy Advocate	About one Million a year	6 cent assessment on policies	<ul style="list-style-type: none"> <li>*Rate filings</li> <li>*Form filings</li> <li>*Rule-makings</li> <li>*Industry wide rate hearings</li> <li>*New initiatives</li> <li>*Consumer Information</li> </ul>	<ul style="list-style-type: none"> <li>*Cannot demand hearing</li> <li>*Review rules before proposed</li> <li>*Participate in industry-wide hearings</li> <li>*Propose new initiatives</li> </ul>
<b>CPPP</b>	Tripartism	Fees comparable to what industry pays, amounting to between 1 and 2 million a year	<ul style="list-style-type: none"> <li>*Payment from petitioning insurer in rate hearings</li> <li>*Payment from fund contributed to by all insurers in non-rate interventions</li> </ul>	<ul style="list-style-type: none"> <li>*Rate filings</li> <li>*Rule makings</li> </ul>	<ul style="list-style-type: none"> <li>*Can insist on hearing if rate request is larger than 7%</li> <li>*Receive written explanation if no hearing is granted for requests less than 7%</li> </ul>
<b>NAIC Con. Part.</b>	Tripartism	Reimbursement of expenses, amounting to about \$100,000 a year	General NAIC Revenue	<ul style="list-style-type: none"> <li>*Crafting model laws</li> <li>*Developing regulatory initiatives</li> <li>*Coordinating</li> </ul>	<ul style="list-style-type: none"> <li>*Designated Forum to present issues</li> <li>*Privileged Access to regulators</li> <li>*Reputational benefits</li> </ul>

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**Preliminary Thoughts on Consumer Empowerment Programs in Insurance Regulation**

All consumer empowerment programs attempt to enhance the regulatory influence of consumers, and thus to check industry sway over regulatory outcomes. But the means used by different programs vary, as do their prospects for success. The case studies above, when considered in light of preexisting research on similar programs, provide a starting point for thinking through these issues in insurance regulation. They also may provide some guidance in regulatory domains, such as banking or securities, that resemble insurance in that they are conducted by states, involve technical regulatory matters, and concern powerful financial interests. Table Five, at the conclusion of this sub-section, summarizes the key points.

**1. Deploying and Designing Proxy Advocates**

Although proxy advocacy gained substantial traction in the 1970s and 80s, its influence has since waned significantly. Part of the explanation for this may be that defining the mission of a proxy advocate is difficult given the conviction of many that there is no single, objective, consumer interest. (Dahl, 1983). Alternatively, proxy advocacy may be objectionable to some because it supplants, or at least complicates, the mandate of the regulator, whose mission also encompasses representing consumers. These concerns are important. But the experiences of OPIC and proxy advocates in the utilities arena suggest that this form of consumer empowerment is nonetheless an under-explored mechanism to counteract industry influence in insurance regulation and regulatory

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contexts that resemble it.

First, there is a broad range of regulatory issues in the insurance context on which a sufficiently clear “consumer position” exists to guide the efforts of a proxy advocate. To date, proxy advocacy has seemingly been premised on the notion that, to be effective, the advocate must be given a uni-directional mandate. Thus, proxy advocacy in both utilities regulation and in the initial conception of OPIC has largely been designed solely to advocate for the suppression of rates in adversarial hearings. But OPIC’s evolution into a more multi-faceted proxy advocate demonstrates that this implicit assumption is incorrect. In fact, proxy advocates in insurance regulation will often (though hardly always) be capable of meaningfully discerning a “consumer position.” Consider, for instance, the initiatives of OPIC to ban discretionary clauses, decrease the time within which health insurers must certify coverage, and strike mandatory binding arbitration provisions in policies. Historical trends show that these positions are “consumer-oriented” and can expect industry resistance. To be clear, that does not mean that these positions are correct or even ultimately in the interests of consumers. Rather, it means that they represent part of a coherent and identifiable set of “consumer positions” which will tend to be under-represented in regulatory processes that do not substantially involve non-industry stakeholders.

This last point raises the second condition for proxy advocacy to represent a sensible strategy for counteracting industry influence: it must be the case that non-industry stakeholders would otherwise fail to effectively present these “consumer positions” to regulators. Proxy advocacy appears to influence regulatory results primarily by providing regulators with expertise and information from a consumer perspective, rather than by applying political pressure. As noted

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earlier, this is how proxy advocates in the utilities arena describe their influence compared to (non-empowered) public interest groups. (Gormley, 1983). The information-without-pressure approach of proxy advocates is also reflected by OPIC's record. In contrast to CW, OPIC never publicly challenges TDI and often frames its successes as a product of cooperation with TDI, as in the cases of its campaign to ban discretionary clauses and its victory in extending the rebate period in the State Farm Lloyds case. It's lack of aggressive advocacy may also partially explain how OPIC involves itself in so many more proceedings than CW: In the last two years, OPIC was involved in twice the number of contested rate hearings as CW, "participated" in about eight times more rate reviews than did CW, and intervened in 100 times more rulemakings or policy form disputes than did CW. OPIC's limited appetite for aggressive advocacy is not surprising: OPIC's Public Counsel is appointed by the same Governor that appoints the head of TDI, and TDI strongly supported OPIC in the face of calls for its abolishment. To the extent that proxy advocates influence results primarily by providing information from a consumer perspective, they are only likely to counteract industry influence when other stakeholders, such as public interest groups or other government bodies, are not performing this role.

Even if these two conditions are met, proxy advocates nonetheless must be well structured in order to influence regulatory outcomes. The OPIC case study provides some limited guidance on this front. Perhaps most notably, it suggests that proxy advocates may be more likely to influence regulatory outcomes when they have procedural rights in the regulatory process. Without procedural rights, proxy advocates lack leverage with which to negotiate settlements with industry participants. It is therefore hardly surprising that OPIC rarely negotiates settlements on rates, given its inability to

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insist on a hearing when it objects to a rate filing. Encouraging negotiation is important, because recent research shows that negotiated settlements are a primary mechanism by which proxy advocates lower utility rates. (Littlechild, 2009). OPIC's lack of procedural authority may also have allowed TDI to dismiss OPIC objections to rate filings without sufficient consideration in 2007, when TDI did not respond to about half of OPIC's objections. Consistent with these observations, in the last several years OPIC has repeatedly asked for the right to demand a hearing if it objects to a rate or form filing. In the rule-making context, proxy advocates could be provided with procedural rights such as the ability to scrutinize draft rules prior to public exposure (as OPIC does) or the right to advise an ALJ regarding the advisability of a rule in a hybrid rulemaking. (Wagner, 2011).

Preexisting literature on proxy advocacy provides additional guidance on this design question. First, it suggests that proxy advocates should be structured as independent counsels, rather than as consumer representative divisions within a state attorney general office or specialized staff within the regulator itself. (Mayer et al, 1988). This is consistent with Texas's own rejection of the Sunset Commission's proposal to abolish OPIC and create a consumer representative within TDI. Second, proxy advocates must employ individuals who have "a greater interest in consumer welfare than in any particular industry in which they participate" and be provided with "sufficient resources to look for agency transgressions." (Barkow, 2010).

## **2. Deploying and Designing Tripartism**

Tripartite consumer empowerment approaches may be appropriate in situations not

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conducive to proxy advocacy. First, unlike proxy advocates, tripartite schemes do not require the existence of a clear-cut consumer perspective. Tripartite frameworks can empower multiple PIGs, each of which may have a particular perspective. This is illustrated by the NAIC consumer participation program, where representatives often clash over their views about which policies best promote the consumer interest. As one long-standing consumer representative, University of Georgia economics professor Brenda Cude, explained: “I’ve been forced to ask myself whether anyone can really represent the interests of all consumers. I’ve concluded the answer is usually no. More often, one must identify the population most at risk in a particular issue and speak on their behalf.” (Goldsmith, 2005). Even if only one empowered PIG exists, as is currently the case in the CPPP, its status as a non-governmental entity creates more leeway for it to embrace its own peculiar view of the consumer perspective. Thus, CW advocated for its preferred regulations on the PAYD and zip-code rating issues even though it is not particularly clear that these views represented the natural “consumer positions.”

Second, in contrast to proxy advocacy, tripartism may be capable of influencing results even if non-industry stakeholders already present “consumer positions” to regulators. This is because empowered PIGs are capable of influencing results not simply by providing regulators with additional information and perspective, but by marrying that information and perspective with the threat of political pressure through the use of media and public outreach. To be sure, even non-empowered public interest groups enjoy some capacity to set off “fire alarms” that prompt broad public scrutiny of agency behavior. (Schwartz & McCubbins, 1984). But empowered PIGS have a better capacity to leverage media sources than ordinary public interest groups given their enhanced

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access to information, richer perspective from direct participation in regulatory processes, and strengthened reputational capital. Even more importantly, empowered PIGs can leverage this threat during regulatory processes to exert pressure on regulators to fully consider their perspective and negotiate and in good faith on that basis.

Both the CPPP and the NAIC Consumer Participation Program illustrate these points, as empowered PIGs in both programs couple their direct advocacy efforts with the threat of extending the regulatory or legislative fight into the public domain. Consider, in this vein, CW's op-ed lambasting the final PAYD regulations, which drew heavily on CW's insurer-financed efforts to articulate and defend its position. Another example is CW's current efforts to expand prior approval rate review to the health insurance domain, which draws on CW's claimed successes in the property/casualty domain through the CPPP program. Similarly, consider the willingness of NAIC consumer participants to use the media to influence the MLR debate or advocate for increased transparency in property/casualty insurance markets.

This willingness of empowered PIGS to couple their information and advocacy efforts with political pressure is a function of several factors. Virtually all public interest groups are naturally adept at using media, as well as other public outreach tools, to convey their messages to the public. Moreover, their self-identity is devoted to their vision of consumer rights in a quite fundamental sense: the people who choose to work for CW or apply to be NAIC consumer representatives tend to be deeply devoted to their particular vision of consumer welfare. Finally, unlike proxy advocates, the existence of empowered PIGs is not jeopardized by the termination of public funding: such groups exist independently of tripartism-oriented consumer empowerment programs, and so,

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compared to proxy advocates, they are more likely to take political risks that could jeopardize the existence of those programs.

However, a key shortcoming of tripartism is that it requires a robust network of public interest groups with broad-ranging expertise and interests. Indeed, Ayres and Braithwaite explicitly acknowledge this point, but assume that “for most business regulatory statutes in a democracy, there will be an appropriate PIG” because “we think it is unlikely that statutes that threaten the interests of business would have been enacted in the absence of an interest group pushing for them.” Similarly, existing critiques of tripartism often focus on the profusion of different interest groups that may adopt “fringe” perspectives or embrace adversarialism. (Seidenfeld, 2000). But the insurance case studies suggest that, in some regulatory settings, the problem with tripartism is precisely the opposite: that an insufficient number of expert PIGs will be available.

Consider the NAIC Consumer Participation Program. In fields such as health insurance, the influence of the program has been dramatic precisely because the program has harnessed the energy of a willing cadre of experts capable of devoting most or all of their time to their roles as NAIC consumer representatives. By contrast, the program’s capacity to counteract industry influence has been muted in other contexts, such as solvency regulation and the regulation of property/casualty and life, where the program simply has not been able to maintain a critical mass of expert representatives. Of the few representatives who do operate in this domain, almost all are only able to devote a relatively small percentage of their time and efforts to NAIC activities and most have a fairly narrow set of interests and expertise.

The California Public Participation Plan illustrates a different risk of an insufficient network

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of PIGs in a tripartite scheme: inefficiency and contentiousness. Recall that when Proposition 103 was originally passed, the program did indeed generate robust participation from a variety of different groups. But as the program has aged, Consumer Watchdog has come to dominate it. Although this hardly seems to have resulted in CW becoming captured by industry or regulator, it is nonetheless troubling. First, CW now enjoys a privileged position in California insurance regulation despite the fact that it often takes controversial positions on consumer issues. Second, CW's dominance of the intervenor program compromises the program's legitimacy, especially because CW's founder and guiding force, Harvey Rosenfield, drafted the referendum creating the intervenor program in the first place. Third CW's privileged position may incentivize it to devote excessive amounts of time and energy challenging industry, because doing so produces monetary payoffs whose appropriateness cannot be compared to other intervenors. As described above, the rates of compensation paid to CW are substantial and paid in virtually every intervention. Not only might this result in higher expenses than necessary, but it also could undermine the capacity for the more collaborative forms of regulation emphasized in the new governance literature, as indicated by CW's aggressive style in advocating for consumers.

In settings where tripartite schemes are deployed, several design principles can be extracted from the case studies. First, tripartite design need not always meet the rigid constraints articulated by Ayres and Braithwaite. To be sure, certain elements appear to be a prerequisite to effective tripartism (or consumer empowerment of any type): representatives must have sufficient technical expertise to understand the effects of regulation and have access to sufficient information to make intelligent decisions. But while it might well be beneficial to allow empowered PIGs to challenge

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industry in the same way as regulators, this procedural right is not always necessary for empowered PIGS to successfully counter-balance industry influence. Ayres and Braithwaite explain the importance of this procedural right as a mechanism to ensure that empowered PIGs have sufficient leverage during all earlier stages of the process. However, a reasonable (though admittedly imperfect) substitute for this leverage is the capacity of empowered PIGs to challenge industry behavior through political pressure and media scrutiny, as described above. This is most clearly suggested by the successes of the NAIC consumer participation program, where consumer representatives do not enjoy any procedural rights.

Second, tripartite schemes should be designed to promote contestability in the future, as well as the present. The evolution of CPPP demonstrates that contestability may be fragile, especially when one organization has a natural advantage. The CPPP design discourages contestability in several ways. Most notably, there is a substantial time gap between the expenditures required of intervenors and their ultimate compensation (about 2.5 years), and intervenor compensation cannot be ensured because it is dependent on an ex post assessment of whether the intervenor made a “substantial contribution.” Additionally, the underlying regulatory process is complex and technical, thus strongly favoring repeat players. Taken together, these factors likely explain why new PIGs have not generally joined, or challenged, CW’s status as the dominant user of CPPP. CPPP might be much more successful at promoting a contestable structure if, for instance, it allowed new organizations to make initial showings of their proposed contributions, provided them with some initial funding based on the likelihood that that contribution would be substantial, and offered training and resources to groups interested in participating in the program.

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Additional lessons for designing tripartite schemes can be extracted from the preexisting literature. For instance, consistent with the Ayres and Braithwaite framework, Jost emphasizes that the NAIC consumer participation program was effective in the health arena because of the open and collaborative nature of NAIC processes, which allows consumer representatives to be involved at every stage of regulatory discussions and negotiations. (Jost, 2011). And, as noted earlier, Seidenfeld helpfully suggests that tripartite systems ought to include mechanisms that ensure that empowered PIGs are effectively representing their constituencies. (Seidenfeld, 2000).

**Table Five: Summary of Tentative Thoughts on Consumer Empowerment Programs**

<b>Type of Consumer Empowerment Program</b>	<b>When to Deploy</b>	<b>How to Design</b>
<b>Proxy Advocacy</b>	(1) Consumer perspective should be identifiable based on historical trends and industry views, even if contestable.  (2) Consumer information and expertise should not be sufficiently presented by non-industry stakeholders.	(1) Should consider providing proxy advocates with procedural rights.  (2) Proxy advocates should be independent government entities.  (3) Should provide sufficient resources and select consumer-oriented individuals.
<b>Empowered PIGs in Tripartite Scheme</b>	(1) No need for single consumer perspective or for absence of non-industry stakeholder participation.  (2) Absence of robust number of willing potential PIGs raises effectiveness and	(1) Procedural rights are not necessary to ensure influence given capacity to exert influence through political/media channels.  (2) Procedures to ensure contestability in future are essential.

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	efficiency concerns.	(3) Involvement of empowered PIGS in all facets of regulatory process and mechanisms to ensure accountability to PIG’s constituents are important.
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**Conclusion**

Different consumer empowerment mechanisms have distinct strengths and weaknesses in counteracting industry influence. When consumer interests are articulable and clear, proxy advocates may be able to provide relevant information and perspective that helps counteract industry influence. Empowered PIGs, by contrast, are free to offer their own subjective set of consumer perspectives during the regulatory process, even when a single “consumer position” is not clear. PIGs can back up this perspective with the threat of political and media pressure. However, such tripartism may be ineffective, inefficient, or otherwise problematic in the absence of a robust network of public interest representatives.

At first blush, these preliminary observations may suggest that proxy advocacy and tripartism are mutually exclusive alternatives. But many regulatory domains involve a range of issues, some more appropriate for proxy advocacy and some more appropriate for tripartite approaches. Employing both forms of consumer empowerment might consequently allow each mechanism to focus on its comparative advantage and safeguard against the limitations and blind-spots of the other. This dual approach need not be costly. As the NAIC consumer participation program suggests, effective tripartism does not require substantial funding where a robust network of potential PIGs already exists. Simply by providing PIGs with improved access to information and regulators, some oversight over early regulatory proceedings, and better access to media,

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tripartism can enhance the capacity of concerned groups and individuals to counteract industry influence. While the costs associated with proxy advocacy may be larger, OPIC illustrates that they are hardly exorbitant. To the extent that even this cost cannot be justified, proxy advocates might be permitted to directly solicit public contributions in the bills that private companies send to consumers, as is the case for some proxy advocates in the utilities domain. Consumers might even be defaulted into providing a small contribution (6 cents a year in the case of OPIC) to fund these programs.

As emphasized at the start of this Chapter, industry influence is not always harmful to the public interest. Nor is it always the case that industry influence is insufficiently counterbalanced by the influence of non-industry stakeholders. But well-designed consumer empowerment programs may be an effective option for responding to situations where the regulated do indeed wield undue power over regulators at the public's expense.

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