

The Department of Insurance—Then and Now

As the last chronicle of events of the 20th Century, the 1999 *Annual Report* provides an excellent opportunity to look back on the Department's history over the past several decades. Interspersed with the summary of important activities during 1999, are interesting facts and figures taken from our archives.

Statutory History

Insurance regulation in Illinois began even before the 20th Century. From 1835 to 1869, three statutes relating to agencies of foreign companies and two relating to taxation were enacted and 279 insurance companies were incorporated by Special Acts of the Legislature. Two of those companies—German Mutual Fire Insurance Company of North Chicago (incorporated February 19, 1867) and Randolph Mutual Insurance Company (incorporated March 26, 1869) are still operating today.

In 1869, the first permanent insurance statutes were enacted to “incorporate and govern fire, marine and inland navigation insurance companies doing business in the State of Illinois.” In the years that followed, another 87 laws and 169 amendments were passed, culminating in the adoption of the Illinois Insurance Code on July 1, 1937. The Code repealed the general acts previously passed, but did not affect the charters of companies that had been specially granted.

Prior to codification, insurance laws presented a maze of inconsistency and ambiguity that resulted in interpretation problems and challenges to the Department's regulatory authority.

Agency History

The first Department of Insurance was created in 1893 and continued as such until the enactment of the Civil Administrative Code in 1917 when the agency became a Division of the Department of Trade and Commerce. A separate Department of Insurance was reestablished in 1933 and given the following charges:

- To see that Illinois insurance companies of every kind are sound and honestly managed and that no company of another state or government, which does not meet the same requirements, shall be permitted to sell insurance to our people;
- To see that every policy contract which is sold to the citizens of this state is fair and reasonable; and
- To see that everyone selling or seeking to sell insurance to the people of this state is honest, competent, well qualified and licensed by the state.

Over the years, that mission has remained largely unchanged. Today, the Illinois Department of Insurance continues to protect the rights of Illinois citizens in their insurance transactions and to monitor the financial solvency of all regulated entities through effective administration and enforcement of the Illinois Insurance Code (215 ILCS 5/1 to 5/1312), the Illinois Pension Code (40 ILCS 5/1–101 to 5/24–109) and related laws and regulations (Title 50, Illinois Administrative Code.)

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“The real purpose of any properly managed state insurance department is to administer laws and conduct a program designed for the benefit and protection of the insurance buying public.”

**—Ernest Palmer, Director
1936**

Our formal **mission statement** is as follows:

To protect consumers by providing assistance and information, by efficiently regulating the insurance industry's market behavior and financial solvency, and by fostering a competitive insurance marketplace.

Agency Organization

Since 1927 (the first year that detailed organizational information is available), the Department has undergone numerous structural changes ranging from the days when virtually every function was a separate "branch" to several variations on the current structure. In addition to our four major Divisions—Administrative Services, Consumer–Market, Financial–Corporate Regulatory, and Legal—the Department sponsors the Senior Health Insurance Program and the Director oversees the operations of the Office of the Special Deputy which handles the affairs of insurance companies placed in rehabilitation, conservation or liquidation.

In 1951 (the first year that head count information was published in an annual report), the Department was staffed by 175 people. Today, we employ 358.



The main offices of the Illinois Department of Insurance in the late 1930s or early 1940s.



The Year in Review

Key Issues

With the enactment of the Gramm–Leach–Bliley **Financial Services Modernization Act** in November, state insurance regulation was presented with one of its most serious challenges. The new federal law establishes a framework for the entry of banks and other financial institutions into the insurance marketplace and was greeted with cautious optimism by the National Association of Insurance Commissioners. Public statements issued by the NAIC pointed to the complexities and potential for legal challenges inherent in S. 900, while noting that state authority to regulate the insurance activities of all providers—including banks—is fully preserved as long as states do not discriminate against banks.

Throughout the year, Illinois Director of Insurance Nat Shapo worked diligently with NAIC leadership to lobby for important consumer protection provisions and a series of amendments designed to address deficiencies in the House version of the proposal, H.R. 10. The final bill, S. 900, incorporated several provisions that bode well for state insurance regulation. First and foremost, it affirms the McCarran–Ferguson Act, which recognizes the primacy and legal authority of the states to regulate all insurance activities; secondly, it mandates that anyone who engages in the business of insurance be properly licensed as required by state law; and finally, it provides for the functional regulation of insurance activities by state insurance regulators.

Recognizing the changing nature of the financial services industry, state regulators are committed to working with federal regulators to improve communications, knowledge and understanding of our respective regulatory responsibilities to ensure that insurance consumers are protected. To that end, a number of state insurance departments, including Illinois, have signed separate information sharing agreements with the Office of the Comptroller of the Currency on handling consumer complaints. These agreements are part of the ongoing effort to strengthen the relationship between two jurisdictions in the new world of financial services modernization. Under these agreements, when a consumer has a complaint about an insurance product sold by a national bank, the OCC will forward that complaint to the appropriate state insurance department. And the state insurance department will forward any complaint it receives about a national bank to the OCC.

In the months ahead, the NAIC will develop a blueprint for state regulation that meets the requirements of S. 900 and preserves functional regulation of the insurance industry.

In mid August, Governor Ryan signed new legislation (PA 91–522) to establish an Insurance Fraud Task Force to look at insurance fraud in Illinois. Chaired by Director Shapo, the task force will:

DOI Archives

In 1932, the Illinois Attorney General ruled that state banks cannot do an insurance agency business. In 1997, legislation was enacted to allow state financial institutions to sell insurance in Illinois.

The Department's 1982 Annual Report notes that, "The carefully defined lines that used to distinguish the various types of financial services are beginning to blur, and while this growing trend can be a healthy one, regulators of financial solvency must keep pace. As the banking, insurance and investment industries become more integrated, consumer education will be essential. And as financial power becomes more concentrated, regulators will be required to consider anti-trust and economic questions in making regulatory decisions. . . . Although it is not immediately clear what direction insurance regulators will take, it is certain that cooperation between various agencies of state and federal government that heretofore has not been necessary will be required."

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- investigate the issue of organized insurance fraud and methods to combat it;
 - examine ways to unite the resources of the insurance industry and federal and state criminal justice systems to identify, investigate and prosecute organized insurance fraud schemes; and
 - explore the need for creating and funding a private agency to assist in combating organized insurance fraud.

The task force will report its findings and recommendations to the Governor and General Assembly in the year 2000.

One of the Illinois Department's most important regulatory initiatives in 1999 was the securitization of insurance risks to increase capacity for financing catastrophic risks and to spread those risks across broader markets.

In July, Illinois became one of the first states in the nation to enact a law, the **Protected Cell Company Act** (PA 91–278), authorizing insurers to offer debt securities directly to the capital markets through protected cell arrangements that allow investors to finance specified insurance risks. The protected cell legislation facilitates Illinois' ability to compete in the global insurance market, while offering an additional safety net to U.S. companies, including our own property and casualty companies which have a significant catastrophic exposure along the New Madrid fault and other catastrophic prone areas of the United States.

Similarly, Illinois' INEX Insurance Exchange marked another "first" by completing the nation's first onshore insurance-linked securities offering. That transaction was also the first securitization with sole exposure to Midwest earthquakes.

The Illinois Department of Insurance chaired an NAIC working group that developed guidelines and standards for U.S. based insurance securitization

transactions. Illinois has also been instrumental in developing protected cell model legislation and accounting guidance for protected cell accounts at the NAIC level.

Tax legislation (PA 91–643) enacted during the year alleviated the **retaliatory tax burden** imposed on Illinois-domiciled insurance companies as a result of the Illinois income tax. This tax burden made Illinois potentially unattractive as a state of domicile for some insurers and could ultimately have had a serious economic impact on the state. To resolve those problems, the new law provides for a reduction to income taxation of foreign insurance companies which:

1. are domiciled in states that impose a lower income tax rate than Illinois; and
2. can show to the satisfaction of the Director of Revenue that their home state retaliates against Illinois insurers on the basis of Illinois income tax.

The law limits the reduction by formula, such that a qualifying non-domestic company's Illinois tax burden for income and other premium taxes may not be reduced below 1.25% of Illinois taxable premium. As a result, the potential retaliation exposure of Illinois insurers is lowered because the Illinois tax rate will not exceed 1.25% of taxable premium in another state.

The law has a built-in sunset of two years. During that time, the Department of Insurance and the insurance industry will closely examine the entire taxing structure to ensure that insurance companies are taxed fairly and that the revenue stream to the state is protected. Several on-going issues remain to be addressed in the coming year, such as protest payments and other potential law suits.

After months of negotiation, **managed care reform and patient rights** legislation became a reality in August. The new law (PA 91–0617) gives Illinois insurance consumers more control of their health care through tighter requirements on health maintenance organizations (HMOs), insurance companies, doctors, and other health care providers. The law generally applies to state regulated managed care plans, including all state regulated HMOs, although some provisions also apply to other insurers.

Among the new patient rights are: the right to receive detailed information from an HMO about all aspects of coverage; the right to receive coverage for emergency services when a "prudent person" would reasonably believe that a condition is serious enough to require emergency medical attention; the right to apply for a standing referral from one's primary care physician when a health condition requires ongoing care from a specialist; and the right to appeal decisions made by an HMO.

1999 at a Glance

- Jan. 6** Former Governor Jim Edgar signs the Mutual Holding Company bill (P.A. 90–810) into law.
- Jan. 12** Governor Ryan appoints Nathaniel S. Shapo Director of Insurance.
- Feb. 9** AAI Syndicate #1 Ltd., a member of the INEX Insurance Exchange, is placed under an Agreed Order of Liquidation.
- March** The Department's web site begins offering on–line access to a variety of producer licensing forms and information.
- March 26** The INEX Insurance Exchange announces the completion of the nation's first onshore insurance–linked securities offering and the first securitization with sole exposure to Midwest earthquakes.
- April 15** The Department's *Annual Report on Insurance Cost Containment* underscores the success of the state's competitive insurance market.
- May** The Illinois Comprehensive Health Insurance Plan marks its 10th anniversary of providing health insurance coverage to uninsurable Illinois residents.
- May** The Illinois KidCare program enlists the aid of licensed producers in increasing enrollment in the state health care program for uninsured children.
- May 25** Director Shapo and nineteen other insurance regulators visit 120 members of Congress to point out the anti–consumer impact of financial services legislation (H.R. 10) and lobby for amendments.
- June 3** Illinois is one of only eight states to receive an "A" rating from the Consumer Federation of American for the complaint information made available to the public.
- June 7–11** Governor Ryan proclaims *SHIP Week in Illinois* to honor the more than 800 volunteers who provide free health insurance counseling to Medicare beneficiaries and their caregivers.
- July 9** Illinois Insurance Company, Oakbrook, Illinois, is placed under an Agreed Order of Liquidation.

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- July 13** The Department releases its 1998 consumer complaint ratios and announces a decrease in complaints from 14,081 to 13,812.
- August** Governor Ryan signs several important insurance bills, including legislation to extend risk-based capital requirements to HMOs and various health service organizations; create the Small Employer Health Insurance Rating Act; create the Managed Care Reform and Patient Rights Act; create the Protected Cell Company Act; and establish an Insurance Fraud Task Force.
- August 19** Illinois Earth Care Workers Compensation Trust, Inc. Is placed under an Agreed Order of Liquidation.
- Sept. 27** Emergency rule to implement new managed care reforms becomes effective for 150 days.
- Nov. 12** S. 900, the federal Financial Services Modernization Act is signed into law.
- Nov. 22** Governor Ryan and Director Shapo announce the members of the Insurance Fraud Task Force.
- December** Director Nat Shapo is elected Chair of the National Association of Insurance Commissioners Midwest Zone.
- Dec. 20** Two Illinois group workers compensation self-insurance pools, The Back of the Yards Neighborhood Council Risk Management Association, Inc. and Illinois Electrical Employers Workers Compensation Association, Inc., are placed under Agreed Orders of Rehabilitation.