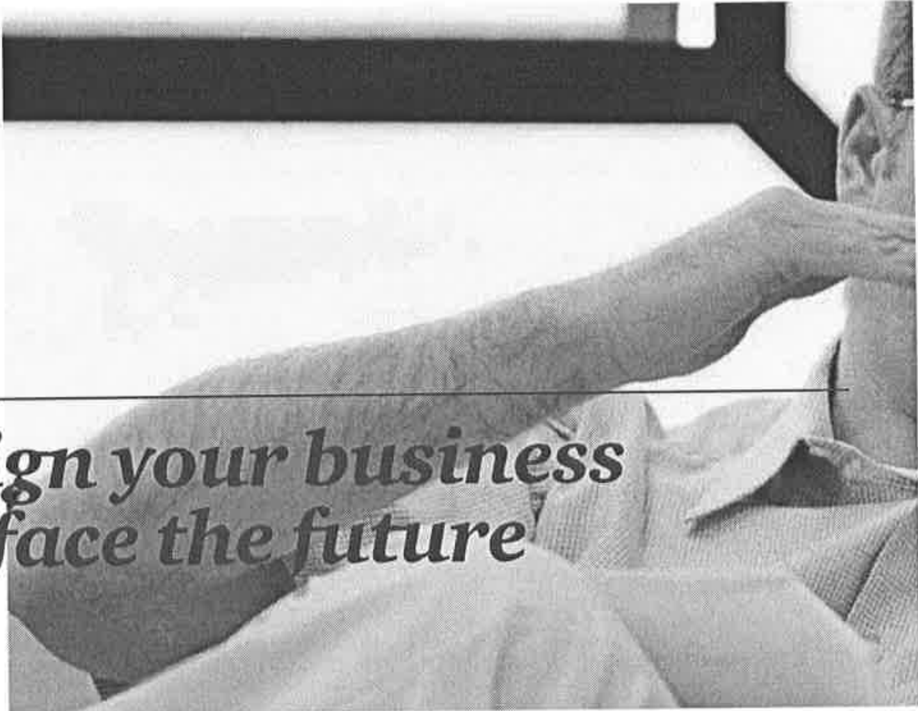


How to design your business strategy to face the future

There is no prescriptive solution about how you should prepare your business for the future scenarios we have described.

While STEEP drivers impact all insurers globally, they have different levels of impact within each region and country.

In addition, the actions that insurers choose to take will depend not only on their national or regional markets, but also on their strategic intent, core capabilities, availability of talent, capital and organisational culture.

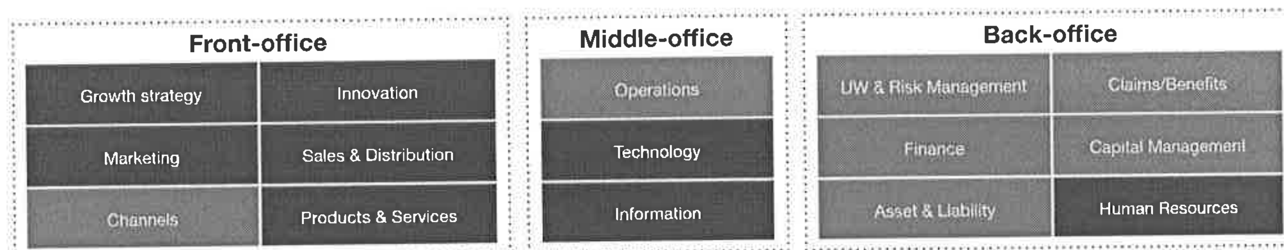
We have, however, identified four broad strategic directions that developed market and emerging market insurers could take, based on their specific situations:

Create your future: Innovators

Insurers who want to reshape the future through innovation. Whether these innovators are in emerging or developed markets, their focus will be on R&D, new product innovation and analytical decision-making techniques. (See Figure 5 for an Innovator's primary areas of focus.) In light of the limited growth opportunities in developed countries for traditional insurance products, developed market insurers will focus on creating value-added loss control and risk management services.

Figure 5: Create your future - innovators and expansionists

This diagram shows the areas of primary focus for an innovator and an expansionist. As both look to reshape their business, much emphasis is placed on front-office activity to disaggregate and re-engineer the value chain. Leaders in these areas will need to be cognisant of the drivers of change and their implications; they'll need to understand the potential impact on the business and also how the business is likely to respond. As change will impact functional teams simultaneously, strong communication, coordination and alignment of thinking will be required to succeed.



■ Primary areas of focus

Source: PwC analysis

Information-based services will be the key innovation in developed markets, using new sources of unstructured real-time information to draw operational and strategic insights. Insurers can use these insights to underwrite and price risk, as well as reduce losses and manage risk. In emerging markets, traditional insurance products will need to be adapted to suit local needs (e.g. micro-insurance or alternative distribution channels).

Create your future: Expansionists

Carriers who want to reshape the future through expansion. They will be growth seekers and not necessarily innovators of new products and services. These carriers will focus on leveraging their capabilities (e.g. customer understanding, product portfolio, capital, diverse talent, Takaful) into adjacent and similar markets around the globe. (See Figure 5 for primary areas of focus.) Expansion can come from moving into new geographies, targeting new customer segments for existing products, and/or introducing new distribution channels to reach customer segments.

Create your future: Fast followers

Carriers who do not want to be the first, but are adept at following the leaders and establishing a strong presence. Fast followers focus on scaling capabilities across a broad market. They are good at sensing new innovations and market opportunities, and are agile enough organisationally to follow and establish a lasting presence.

As Figure 6 shows, the primary focus of activity for fast followers lies away from the front office, demanding agility in operations, technology, information and the back office to respond to new business models and create operational excellence.

Figure 6: Create your future - fast followers and survivors

Front-office		Middle-office	Back-office	
Growth strategy	Innovation	Operations	UW & Risk Management	Claims/Benefits
Marketing	Sales & Distribution	Technology	Finance	Capital Management
Channels	Products & Services	Information	Asset & Liability	Human Resources

■ Primary areas of focus

Source: PwC analysis

Create your future: Survivors

Carriers who are focused on short-term performance and survival. These carriers wait for a majority of the industry to adopt new ideas and practices before adopting them. They tend to be organisationally hierarchical and slow to respond, but can be operationally resilient and efficient.

What do you want to be?

Each of the above strategies is not necessarily superior or inferior to the others. In a conservative industry like insurance, there will be more survivors and fewer fast followers, expansionists and innovators. However, having a clear strategic direction about 'what you want to be' will be critical in determining how you design your business to manage the risks and exploit the opportunities that come your way.

What's on your mind?

Figures 5 and 6 show the functions engaged in implementing and embedding a new business strategy. Your perspective on change will be shaped by where you sit in the business. Here we've highlighted just a few considerations for the executive team when formulating a new strategy:

CEO	Who do you task with shaping the response to all this change? Who will drive innovation to anticipate and respond to a changing market? How do you decide which markets, countries and customer segments to target? How do you prioritise your investments, and build the capabilities to survive and exploit the changing market?
CRO	How well is risk management embedded in your organisation and will you be comfortable with the risk assessments on new products, services and distribution channels? How can you be better prepared to anticipate and prepare for extreme 'Black Swan' events?
CFO	What will be the impact on your message to the market? How can you manage the capital and balance sheet structure of your company under changing regulatory, market and rating agency expectations?
CMO	How do you transform your organisation into a customer-centric organisation that is capable of marketing and tailoring products to your consumers' changing attitudes and behaviours?
CTO	How do you ensure the organisation is not only aware of the emerging technology trends, but is also actively involved in experimenting with new technologies as they come to market?
CIO	How do you ensure that you build an information advantage enabled by rich, insightful data, fully supported by a cost-effective technology platform?
Head of Actuarial	How are you ensuring that you can select and price risk appropriately, based on your risk appetite?
Head of Underwriting	Can you exploit new sources of information to improve better risk selection and pricing?
Head of Claims	Can you transform your organisation from paying claims to actively managing the losses based on real-time data and loss management techniques?
Head of HR	How do you ensure that you continuously attract and retain the right talent within the organisation – especially when the talent has to be culturally aware, multidisciplinary and global?

Giving you the edge

Whether you are a personal, commercial, individual life and annuities, group benefits, or retirement provider, you will see fundamental changes to your business models, value chain and how you acquire, retain and train your highly skilled talent over the next decade.

Irrespective of whether you are a developed market, emerging market, or global insurer, you need to anticipate these changes and prepare for growth.

PwC has developed and facilitated three types of workshops to help clients plan for the future:

Fiercest Competitor workshop

Fiercest Competitor is a rich, fast-paced experience that challenges leadership teams to imagine what could significantly disrupt their sectors, and then think about how they can drive that disruption to elevate their businesses to a higher level of competitiveness. We will help you create your worst competitor nightmare, so you can identify your organisation's weaknesses and where you need to modify its approach. This session helps you explore what plans you need to put in place to future proof your business and identify who is best placed to deliver.

Future Positioning series

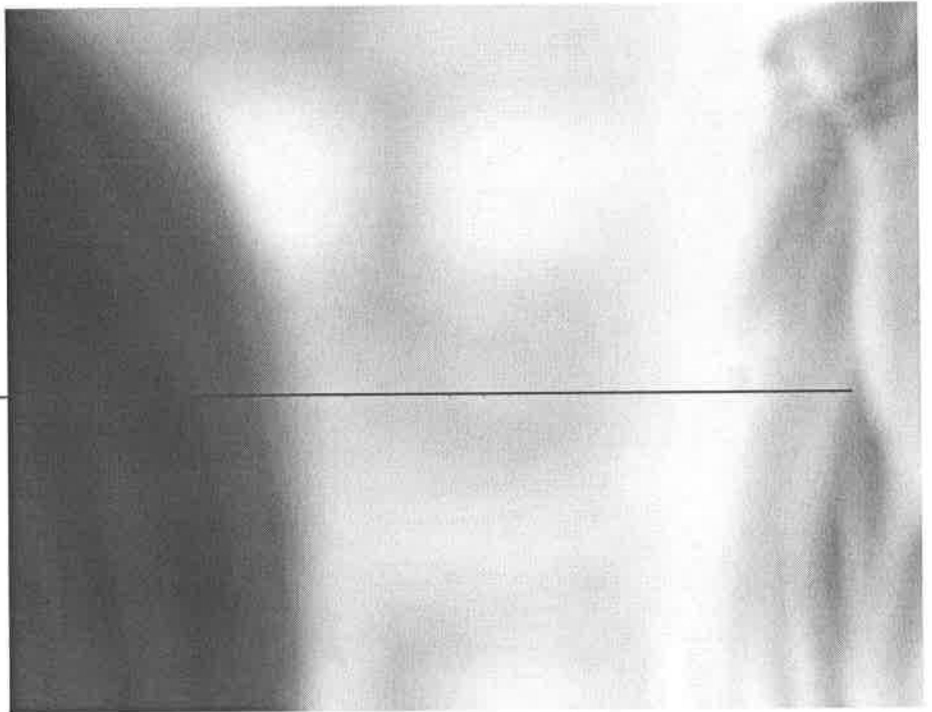
PwC works with insurance clients to identify the business drivers key to their business and market positioning across the five STEEP categories and then helps the client rate those drivers against what they feel are important. After assessing the impact of each driver on business functions, PwC will help clients make changes to their business design to avoid risks and exploit future opportunities while equipping them to Act, Prepare and Monitor:

- **Prepare:** Determine 'no regret' moves to be completed in the near-term.
- **Act:** Start those activities that have a longer lead time.
- **Monitor:** Identify future signposts to act at a later time.

Global growth strategy

By utilising our detailed and multifaceted approach to planning international growth, insurers can implement a well-planned and executable strategy. When expanding internationally, insurers should consider the unique profile of specific territories relative to their unique capabilities and positioning. Our proprietary frameworks and tools, including Growth Radar™, Growth Navigator™, and Growth Pursuits™ help insurers define and execute their international growth strategies.

This paper covers only a little of the picture and there is much more to share and discuss. To find out how PwC can help you understand what's beneath the surface and support you in the creation of your future, please contact the team listed on the next page.



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INVITED ARTICLE

The Politics of Insurance Regulation

Kenneth J. Meier

Even though insurance is the largest state-regulated industry in the United States, it has received almost no scholarly attention in the political science literature. Until the publication of *The Political Economy of Regulation: The Case of Insurance*, only one political science book examined the politics of public policies affecting insurance and that covered only the regulation of life insurance investments in a single state (Orren, 1974). The purpose of this essay is to outline a political theory of insurance regulation and apply political science theories of public policy to the politics of insurance regulation. The essay assumes that insurance regulation is similar to other forms of regulation, that it is inherently a political process whereby political actors seek to allocate the powers of the state for their own benefit. Accordingly, the goals of insurance regulation must be viewed as multiple and political rather than just in terms of correcting market failures.

Based on studies of other industries, elaborate theories of regulatory policy exist in the literature (Wilson, 1980; Meier, 1985; Noll and Owen, 1983; Reagan, 1987). Regulatory policy, in these theories, is viewed as resulting from the interaction of "political institutions" within an environment that influences the abilities of these institutions to use their political resources effectively. Four major political institutions or political actors (or sets of actors) have been identified: the regulatory agency (i.e., the insurance commission), the regulated industry (in this case the insurance industries), non-industry interests (primarily though not exclusively in this case consumer interest groups), and political elites (legislators, chief executives, federal officials, et al.). Regulatory issues take place in an environment that varies in both complexity and salience. This environmental variance systematically advantages and disadvantages each of the political actors depending on how salient or how complex the policy issue under consideration is. This essay will link each of the four major actors in insurance regulation to broader theories

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This is an invited article based on the author's book entitled *The Political Economy of Regulation: The Case of Insurance* (New York: St. Martin's Press, 1988). The book won the 1990 Clarence Arthur Kulp Award given by the American Risk and Insurance Association.

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of regulatory politics, and then tie the actors together with a discussion of the policy environment.

The Regulatory Agency

All 50 states regulate the insurance industry with a regulatory agency normally called the insurance commission.[1] Economic theories of regulation, as well as pluralist political theories, treat regulators as passive, neutral arbiters (Stigler, 1971; Posner, 1974; Peltzman, 1976; Truman, 1950; Noll and Owen, 1983). Policy, according to this view, is determined by the competition of private interest groups with the regulator merely ratifying the results of the interest group process. While this view has spawned a great deal of research, it is clearly not a valid description of how insurance or any other industry is regulated in the United States. Recent political theories of regulation treat regulators as political actors in their own right. As such they have their own policy goals that they wish to achieve and the autonomy necessary to make policy decisions (Sabatier, 1988; Meier, 1988, p. 27). In normal regulatory times such decisions take place in interaction with the industry but with little outside input from political elites.

Regulatory Goals

Insurance regulation is characterized by multiple goals: solvency, fairness, access, stability, local protectionism, and social objectives (Miles and Bhambri, 1983). Differences between the goals held by insurance regulators and the goals of the insurance industry generate the politics of insurance regulation. Regulators, because they are subject to a wide variety of political pressures, frequently stress different goals from those preferred by the industry. Regulators can be viewed as politicians seeking to gain political support for their agency (either for use in budget battles or to generate greater autonomy for the organization in the policy process; see Rourke, 1984).

Solvency: The major economic goal for insurance regulation is solvency. Because insurance is an industry that collects payments today to cover potential losses at some future time period, the insurer must remain solvent for an insurance contract to have any value. Solvency is quite likely the prime regulatory goal of the industry; solvency was used in the 1940s to justify the need for price regulation to protect the industry from the destructive effects of competition (Joskow, 1973, p. 392). It remains a major justification today for industry opposition to restrictions on rates or the calculation of rates (e.g., prohibition of rates based on residence, see Ream 1989). All regulators accept the solvency of insurers as a regulatory goal. The difference between

[1] Political scientists normally think of a commission as a multimember board since this is the pattern adopted by federal regulatory commissions and most other state regulatory commissions. A commission with a single commissioner is somewhat unusual as is the use of a board to set rates (as some states do) with administrative power vested in a single insurance commissioner.

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regulators and the industry is that regulators generally have several other goals in addition to solvency.[2]

Fairness: The insurance market is generally characterized by information asymmetry, that is, the insurer has a great deal more knowledge than the consumer (Formisano, 1982, p. 23). The objective of fairness regulation is to prevent this information asymmetry from distorting the market to the disadvantage of the consumer. A variety of regulatory policies have fairness as a goal: the establishment of specific policy language, limits on the types of insurance contracts, information presented on prices and claims service, and concerns about low loss ratios. Fairness is not just a consumer issue; the industry has recently raised a wide variety of fairness concerns. Recent changes in tort law and product liability have led to arguments that insurers need to know specifically what the extent of their liability will be and how the laws will be interpreted (Wasilewski, 1986, p. 14). Claims made policies, efforts to limit punitive damages, and several other tort reform issues can be interpreted as fairness issues. Insurance regulators vary greatly in their support of fairness goals for either consumers or industry.

Access: Market systems use price to compensate for high risks. Market prices, however, limit access to insurance to those who can afford the market price. While insurers are likely to support some access goals when accompanied by government subsidies (e.g., flood insurance), regulators are much more likely to be advocates of greater access. Doing so usually requires some cross-subsidization whether it be via an assigned risk pool or a ban on using certain classifications that are correlated with risk (e.g., urban residence, AIDs). Increasing access, as a result, usually challenges the actuarial base of the insurer (thus generating opposition) while increasing the potential political support of the regulator.

Stability: Although price stability is not frequently discussed as a regulatory goal, Simons (1989) argues that it should be. Consumers react negatively to large rate increases after several years of constant rates. Simons suggests that stability should be a high priority for industry interests. Instability, he argues, activates consumer groups and political elites which in turn has political ramifications for the industry.

Local Protectionism: As political actors, the support of domestic companies is more valuable to the regulator than support from foreign insurers. The value of this support can quite easily be translated into an effort to protect local companies. Although the extreme measures used in the past (banning foreign companies and discriminatory premium taxes) are no longer legal, local protectionism may have become more subtle. The author hypothesizes that local companies are more likely to be consulted on policy questions and their complaints about regulation are more likely to be heard.

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[2] The claim that regulators all have solvency as a goal is a broad one, but the author has yet to interview either a regulatory commissioner or a member of the regulatory agency who did not hold this view. They might disagree with industry representatives about the best way to attain solvency or how serious various threats to solvency are, but they accept the goal.

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Social Objectives: Because they need to generate their own political support, regulators often seek social objectives (as distinguished from economic objectives) in insurance regulation. Perhaps the most obvious are requirements for the investment of assets or tax incentives to invest capital in ways that insurers would not normally do (Orren, 1974). Social objectives are most common in regard to investments, but they also frequently occur in other issues such as the prohibition of redlining neighborhoods and using gender as a risk classification.

Regulatory Resources

Differences in regulatory goals explain the differences in objectives between regulators and insurers. The ability of regulators to impose these objectives on the insurance industry is a function of regulatory resources. The insurance industry is highly complex, and regulation in many areas is a technical process. As a result, regulators need to develop some expertise or run the risk that the policies they propose will be shown to be inadequate or will fail in implementation. Students of bureaucratic expertise have concluded that the minimum necessary conditions for developing bureaucratic expertise are a large number of employees (so that specialization is possible) and adequate financial resources to attract talented employees to the organization (Rourke, 1984; Berry, 1979; 1984; Benveniste, 1972).

The striking fact about state insurance commissions is their variance on these measures. The commissions range in size from a few dozen employees to several hundred employees; resources range from totally inadequate to sufficiently ample to compete with other state agencies for qualified personnel. A large number of state insurance commissions quite frankly lack the regulatory resources to be an effective regulator of the insurance industry even with help from the National Association of Insurance Commissioners' staff. U.S. Representative John Dingell (D-MI) recently concluded that lack of regulatory capacity was a major reason for the rise in insurer insolvencies in the late 1980s. Lacking a regulatory agency with the capacity to regulate means that the insurance industry is quite likely to dominate the agency (since the commission must rely on the industry for the bulk of its information). In such a policy system, regulatory issues are more often decided in the legislative process since legislators cannot rely on the expertise of the regulatory agency to resolve insurance issues. The insurance industry can also be harmed in such a situation. Without an effective insurance commission, salient issues will be settled by political institutions using political criteria. An effective regulatory agency can often limit political decisions because it brings an objective form of analysis to the policy debates.

Despite the variation in insurance commission resources, insurance regulatory agencies can generally be characterized as fairly weak. In comparison to other agencies or even other state regulatory agencies, they are generally small (exceeding in size only those agencies that regulate professions—see Meier, 1985), they do not have a great deal of political support from sources other than the industry, and many have developed little

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expertise. Such regulatory agencies should in theory be dominated by the industry that it regulates.[3] In practice, however, many of these regulatory agencies are not controlled by the industry. The explanations for this relationship can be found in the structure of the regulated industry.

The Regulated Industry

Theories of public policy generally associate the success of an industry in achieving its regulatory objectives with its economic resources. In terms of economic resources, insurance is one of the largest industries in the United States. With nearly two million employees and hundreds of billions in assets, the insurance industry has economic resources that are the envy of virtually all other industries. Economic resources, however, do not translate into political resources. Two factors in particular, mobilization and cohesion, limit the impact of insurance resources in the policy process.

Business organizations, in general, only mobilize a small portion of their economic assets for political purposes (Greenwald 1977). Among business interests, however, insurers have mobilized less than the norm. Insurance industry efforts in support of tort reform, for example, were eventually stalemated at the state level and cannot seem to make the institutional agenda at the federal level. This example suggests that trial attorneys and their allies, although much smaller in terms of economic size, appear to be much more skilled politically than insurers. Similarly, the life and health insurance and the property-liability insurance segments of the industry lost two expensive battles over taxation in the early 1980s when their opposition appeared to be a single member of Congress (see Meier 1988, pp. 127-31). In what has become a guerrilla war in the courts and federal regulatory agencies, banks appear to be winning their battle to enter the insurance industry (see Crenshaw 1991). Perhaps one reason for the insurance industry's relative lack of political skills is that it came relatively late to the modern pressure group process. Since insurance is state regulated, the major consumer/business battles of the 1960s and 1970s at the federal level which caused business organizations to mobilize greater political resources (Vogel, 1989) touched the insurance industry only at the margin. State-level interest group processes in the 1960s and 1970s were far less developed and were not nearly as good a training ground to develop interest group skills as was the federal level.[4]

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[3] The best example is the agencies that regulate the professions (e.g., medicine, law, barbering, dry cleaning, etc.). These agencies are small, often staffed only with part-time help. Although some of these agencies are able to achieve some independence from the industries that they regulate, for the most part the regulated industry completely dominates these agencies (see Meier 1985, chapter 7; Rottenbergh, 1980; Blair and Rubin, 1980).

[4] The need to mobilize resources is especially the case when interest groups want to get something rather than prevent something. Interest group studies generally argue that interests seeking to prevent some action have an advantage over those who seek to establish a new policy because the policy process has numerous veto points and defensive interest groups need only win at one of these veto points (see Anderson 1990).

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A far more crucial variable affecting the insurance sector, however, is cohesion. Interest group theories generally associate cohesive industries and coalitions with successful policy efforts. Studies of airline deregulation and banking deregulation both credit, among other things, the lack of cohesion in the industry for its inability to retain protective regulation (Derthick and Quirk, 1985; Brown, 1987; Meier, 1985, chapter 3). Cohesion in the insurance industry is a problem because the industry is highly segmented with little serious effort to build coalitions across segments.

Although insurance is often perceived by outsiders as a single industry, it is really several separate industries that provide differentiated products. The industry itself divides insurance into two industries, the life-health insurance industry and the property-liability insurance industry. Each industry has separate histories, separate professional organizations, separate regulatory agendas, and separate political goals. Were insurance only two industries, however, its political problems would be substantially less.

Politically and perhaps economically, it is more accurate to perceive the insurance field as several industries rather than just two. Separate lines of insurance are concerned with different policy issues and have different policy agendas. While there is some overlap, recent policy issues reveal the lack of common political interests among the different lines of insurance. During the 1985-1986 product liability crisis and the effort to adopt tort reforms, the bulk of the political work was done by the commercial liability industry and their organizations. Absent from the debates were not only the life-health industry but also for the most part firms representing the personal lines of insurance. Recent efforts to restrain the costs of automobile insurance have reversed the tables; the large automobile insurers are at the point with little help from others. Similarly, recent efforts to limit medicare and medicaid reimbursement as part of the federal budget process see the health insurers battling alone.

Lines of insurance are not the only cleavage limiting cohesion. Companies that are direct writers have different political interests from those who operate through agents. A representative of a major automobile insurer recently noted that he did not particularly care if states followed California's lead and adopted mandated rate reductions; as the low cost provider of auto insurance, they would flourish at the expense of the nondirect writers.[5] Agents have interests different from the companies they represent. Mutual companies have different interests from stock companies as demonstrated by the federal taxation fights of the 1980s (Meier, 1988, p., 128).

The result of this fragmentation is an industry that can be thought of as lacking sufficient cohesion to prevail in the political process. Coalitions with business and other interests outside the industry are often easier to make than coalitions within the industry. Medical malpractice insurers have more in common with physicians than they do with companies that write homeowners insurance.

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[5] Personal interveiw with the author.

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This assessment should not be taken to imply that the insurance industry always loses or is the weakest industry politically. Rather it is a relative argument. The insurance industry is a economic power; in contrast it is a political wimp. Given its resources, the insurance industry should have the same influence on the regulatory process as the automobile industry. The insurance industry often has great difficulty in defeating interests that are far weaker than it is, and sometimes loses politically to coalitions that it should easily defeat. A lack of mobilized resources and cohesion is only part of the explanation for this (tactics, see below are another), but they are a significant explanation.

Consumer Interests

Consumer interests will be used as a generic term to cover all noninsurance interests that are concerned with insurance regulation. These interests vary greatly from issue to issue and include at various times businesses and individuals who purchase insurance, trial attorneys, environmental groups, women's organizations, labor unions, and consumer organizations such as the Consumer Federation of America, etc. Those consumer organizations and their leaders that routinely receive the media attention such as Robert Hunter of the National Insurance Consumers Organization, Joan Claybrook of Public Citizen, or Ralph Nader are only one small part of the realm of consumer interests.

If political victories went automatically to the coalition of interest groups with the greatest economic resources or the greatest mobilized political resources, the insurance industry coalition would rarely lose. Only on major federal issues such as permitting banks to sell insurance or eliminating gender as a rating category does the noninsurance coalition come even remotely close to the resources of the insurance coalition (Bykerk, 1989). In most cases the noninsurance coalition is at a distinct advantage. Two factors contribute to the victories by noninsurance coalitions.

First, political skills quite clearly matter. Although Ralph Nader and Robert Hunter are minor players in insurance policy especially at the state level, they are masters at attracting media attention to their cause. An examination of a variety of insurance issues would reveal numerous cases where smaller noninsurance interests have been able to use their greater political skills to influence policy (tort reform in large states, auto insurance prices in California).

Second, all interest groups face what Gamson (1968) has called a mobilization of bias which can be described as how favorable or unfavorable policymakers perceive an interest. Insurers face a mobilization of bias that is distinctly unfavorable. The industry's own image that they are responsive companies that quickly assist policyholders to overcome temporary or major set backs (e.g., the response of insurers to major disasters, or even the processing of day-to-day claims) appears to count for little in the eyes of policymakers. The general perception of the insurance industry is that it is a

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highly profitable industry that offers a product that is relatively expensive.[6] Schweig and Gasper (1989, 22) attribute the industry's poor reputation to how consumers are treated by insurance companies.

Consumer groups, on the other hand, generally face a mobilization of bias that is favorable to them especially in liberal policy environments. Consumers are the little person, the David combatting with Goliath even when the consumers are represented by a wealthy trial attorney. The result is a general preference of the political system to support consumer group positions.

Evidence presented by consumer groups is often given equal credibility to that presented by insurers even though consumer groups generally lack the expertise possessed by the industry. Although this relative credibility reflects the general mobilization of bias of policy systems in favor of consumers, part of it is the fault of the industry. Reflecting the nature of the industry (accepting payments now to cover risks incurred in the future), the industry is conservative and highly risk averse. Any change in law happening today can have major ramifications for insurer pay outs in the future on policies sold in the past. Insurance industry lobbyists reflect the industry's risk averse nature and tend to emphasize the worst that can happen. In the process they have gained somewhat of a "Chicken Little" reputation among policymakers. Industry contentions especially when accompanied by extreme anecdotes that are outside the experience of most individuals are discounted if other interests are present to challenge them.

Political Elites

Political elites at the state level include the legislature and the governor. At the federal level, the President and his appointees and members of Congress are considered political elites. Political elites play two roles in the policy process. First, they serve as an appeals board for decisions made by the insurance commission. Insurance commissions report to the legislature and the governor who are hierarchically superior to the commission. They have the authority to reverse commission decisions by legislation or executive order. Second, political elites also have policy preferences that they seek to impose on the policy process absent any appeals from a regulatory system. For the most part, very few of the policy preferences of political elites involve insurance so the regulatory system is generally left alone. On issues with the right

[6] This is a perception that may or may not be accurate depending on the situation. The expensive product perception is almost universally held by policymakers that have been interviewed by the author. Expensive is a term used relative to individual payments not the return to the individual or any attempt to balance the books of the industry. It is a general perception which may or may not have any empirical support. I suspect this occurs because literally thousands of persons can be found who have paid insurance payments for many years and never had a claim. During the property and liability crisis of 1985-86, testimony from small businesses who could not get insurance despite long histories of no claims were common. Empirical evidence on the profitability of the industry tends to be published in sources read by insurance industry leaders and insurance academics rather than being widely distributed among the general public.

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characteristics, however, political elites are quite willing to intervene in the regulatory process.

Although insurance regulation is not generally a partisan issue, when political elites become involved, partisanship is often related to the goals that are sought. Democratic politicians, particularly liberal Democrats, are more likely to pursue goals of access, fairness, and social responsibility than are Republicans, particularly conservative Republicans. In theory, Republican politicians should also be more supportive of solvency goals and a general preference to let the market system rather than the insurance commission regulate the behavior of insurers.

The likelihood of insurance issues reaching the political agenda is related to the competitiveness of the political system within a state. Similar to other areas of regulation, when a single political party dominates the politics of a state with little threat of replacement by the other party, industry preferences receive more weight (Meier, 1988, chapter 7). Absent any electoral consequences, the natural economic advantages of insurers mean that political elites are more likely to cultivate the insurance industries. When the parties are in competitive balance, the modest resources of consumer groups become more important especially if responding to these groups can be used in the politician's election campaign.

Even within a competitive political system, insurance issues only rarely become major legislative issues. Insurance is a highly complex industry; many politicians are unwilling to invest their own personal resources to learn the nuances of insurance regulation. Although there are ways to reduce such information costs (see below), the politician has a variety of issues to chose from and, as a result, issues other than insurance are likely to be more attractive to most politicians.

Despite these barriers to political elites on insurance issues, numerous politicians have made insurance a keystone of their political agenda. The Florida state legislature responded to the tort reform movement by imposing a series of restrictions on the industry in 1986. Governor James Florio of New Jersey made insurance costs a key part of his campaign for office and part of his legislative program in 1990. In 1990 Governor-Elect Anne Richards of Texas included insurance costs as part of her agenda in her victory speech on election night.

The Policy Environment

The policy environment structures how the various policy actors interact and influences how much each actor's policy goals are reflected in public policy. The policy environment does this by creating an environment that systematically favors the political resources of one policy actor rather than another. The policy environment does not determine winners or losers but rather alters the odds of winning or losing. The theoretical work of Gormley (1986) argues that the two key characteristics of the policy environment are issue salience and issue complexity. A salient policy issue is one where a large

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number of persons feels that the issue affects them and that the political system is a way to address the issue. Environment protection, war in Iraq, and the Savings and Loan crisis are salient issues at the present time. Regulation of accounting practices, setting utility rates, and determining policy forms are generally not salient issues; they simply lack the scope (number of persons interested) that is generally associated with a salient issue.

A complex issue is one where specialized knowledge is required to understand the policy question. Complex issues might include policies on global warming, medical research issues, and methods of financing government debt. Issues with little complexity might be pornography, a bottle-deposit law, and the imposition of a sales tax.

Issue complexity affects which actors can effectively participate in policy discussions because a lack of knowledge limits the contribution that an actor can make. In short, issue complexity increases the costs of participation in the policy process by requiring that political actors learn the intricacies of the public policy under consideration. Issue salience affects the rewards of the policy process; the greater the salience of a public issue, the greater the potential political benefits that can accrue to a policy actor who influences public policy.

Combining both issue salience and issue complexity generates a set of conditions that Gormley feels benefits certain actors over others. When issues are complex yet not salient, the major participants will be the regulated industry and the regulatory agency. The regulated industry must participate in all cases (complex or not, salient or not) because regulation has a major economic impact on the industry. Similarly the regulatory agency must participate whether or not issues are salient or complex. Whether the industry or the commission has the capacity to participate effectively, however, is an empirical question.

Issues that are salient, whether or not they are complex, are issues that are likely to bring the participation of nonindustry groups and political elites. Salience increases the rewards for participation. As it increases to a high enough level, political elites will perceive the rewards for intervening in the policy process outweigh the costs. A complex issue will have to be more salient than a noncomplex issue to attract the participation of political elites since complexity affects the costs of participation. Complex but salient issues rarely have effective nonindustry participation (unless these "consumers" are also highly sophisticated industries themselves). For general consumer groups, the issue must be noncomplex as well as salient.

Gormley's theory of policy environments makes several predictions. In complex but nonsalient policy environments, policy will reflect the relative resources of the regulated industry and the regulator; consumer groups and political elites will have little impact. In noncomplex but not salient issues, regulatory policy will reflect the relative resources of the regulatory agency, the industry, and the nonindustry interests; political elites are unlikely to participate. In complex but salient issue areas, regulatory policy will be determined by the relative resources of the regulatory agency, the regulated

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industry, and political elites. Finally, in noncomplex but salient issue areas regulatory policy will reflect the resources and goals of all four policy actors.

Insurance regulation in general is complex but not salient. Much regulation focuses on technical issues that are only of remote concern to most consumers (e.g., policy forms, accounting standards, reporting requirements). Overall insurance policy should generally reflect the interaction between the industry and the regulatory commission with only modest input from political elites and consumers. Given the relative lack of resources assigned to regulatory agencies, such an environment would generally suggest that regulation would reflect the interests of the insurance industry, especially if the industry were relatively united in its policy goals.

The important aspect of policy environments, however, is that insurance issues vary in both salience and complexity. The price of automobile insurance has become a salient issue in a variety of states; an insurance company insolvency (or more likely several) will greatly increase the salience of solvency issues, the use of gender as a rating category is salient in Montana, Pennsylvania, and a few other states. Insurance issues also can be made less complex even if they are not in practice. Rather than deal with the technicalities of prior approval rate regulation, proposition 103 in California attempted to simplify this complex issue by presenting a direct 20 percent reduction in premiums. The proponents of this ballot initiative were successful in simplifying the issue and thus inviting the participation of persons who rarely think of insurance.[7] Representative Pete Stark dramatically simplified the issue of insurance industry taxation in 1982 and 1986 by proposing fairly blunt taxes and forcing the industry to solve the complexity problem for him by providing alternatives capable of producing the same revenues (Meier, 1988, p. 131).[8]

In competition between industry and nonindustry groups for insurance policies, the ability to manipulate salience and possibly complexity suggests different tactics. Nonindustry groups will rarely win in nonsalient complex situations (unless the regulatory agency has values that generally favor the consumers). It is in the best interest of nonindustry groups, therefore, to make issues as salient as possible and attract support as a result from political elites who would not normally be concerned with insurance policy. It is also in the best political interests of consumer groups to simplify issues as much as possible so that they can appeal to a greater number of consumers.

The insurance industry will rationally adopt the opposite strategy. Increased salience will bring additional actors to the policy process and weaken the industry's relative control over the process. The industry in such a situation

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[7] Whether or not the simplification results in an accurate presentation is a different question. Simplification invites greater participation, it may or may not be meaningful participation as the rest of the policy process then deals with the policy issue. In the case, of proposition 103, the courts also intervened to reintroduce the complexity of the issue by establishing the satndards for automobile insurance rates.

[8] The process of simplifying an insurance issue does not always result in success for nonindustry groups. The 1990 defeat of propostition 201 in Arizona is an example.

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should not increase the salience of an issue unless it feels it will clearly lose at the regulatory agency level. Similarly, the industry has little interest in simplifying issues; this lowers the costs of participation to nonindustry groups and weakens the relative resources of the industry.

This logic suggests a major tactical error by the insurance industries in recent regulatory policy issues. In several cases, the liability crisis of the mid-1980s, the automobile price debates of 1988 through 1990, the taxation of life insurers, etc., the insurance industry has engaged in a process of what is termed "grass roots lobbying." Grass roots lobbying is essentially using public relations techniques to communicate the issue to the general consumer public. A variety of interest groups, probably the most successful is the National Rifle Association, have used grass roots lobbying effectively in policy disputes. Such a tactic, however, is ill-informed when used by the insurance industries since it increases issue salience and generally decreases complexity. Both results are more likely to benefit nonindustry groups, especially consumer groups, and also likely to attract the interest of political elites who may well have policy interests hostile to the industry.

Conclusion

This essay has applied a political theory of public policy to insurance regulation. *The Political Economy of Regulation: The Case of Insurance* uses this theory to trace the historical development of insurance regulation, to discuss contemporary federal issues of insurance policy, to assess the liability insurance crisis of the mid-1980s, and to guide a quantitative analysis of insurance regulation in the 50 states. The striking aspect of this study is the mixed political fortunes of the insurance industries. By all normal political criteria, insurers companies should dominate the regulatory process. In reality they do not. The industries' lack of cohesion and poor choice of political tactics permits weaker coalitions to stalemate and at times defeat the interests of the insurance industries.

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