

# **Department of Banking and Insurance** **Transition Report**

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# **Department of Banking and Insurance Transition Report**

## **EXECUTIVE SUMMARY**

Throughout the interview and examination process conducted by the transition subcommittee, two common themes emerged regarding the operations of the Department of Banking and Insurance (DOBI). The first is that DOBI operates more effectively than numerous other departments in state government and is generally perceived that way by the industries it regulates; the second is that staffing restrictions prohibit DOBI from fulfilling its mission as effectively as it should. The unique funding source for the Department contributes to the first, while disregard for this self funding procedure contributes to the second.

DOBI's effective operations appear to stem from the fact that it is more of a regulatory agency than a policymaking agency; however, some individuals within DOBI have apparently attempted to make it a policymaking department based upon their role as regulators of particular lines of products. Going forward, the Department should aim to operate primarily in its role as a day-to-day regulator, unless policymaking is required by extraordinary circumstances. DOBI should also work with the various regulated industries and the policymakers in the Legislature to ensure that the oversight it provides is not only sufficient, but in line with other regulated industries within this state as well as others. Additionally, as the new administration continues to lay out its policy objectives, the Department should assist in developing and supporting workable concepts.

An analysis of the Department, as well as issues anticipated to arise during the next six months examines the operations undertaken or in need of attention in all three areas that the Department regulates. Additionally, persistent problems that have affected DOBI's ability to operate at its highest level are also detailed. Many of these have stemmed from the actions undertaken by previous administrations, particularly the outgoing governor.

Of note, a number of recommendations are also made that should allow the respective divisions to operate at a higher level of effectiveness, whether they remain within DOBI or are relocated to another department within the Executive Branch. Also included are recommendations that will bring additional responsibilities under the oversight of DOBI, which it is felt that the Department can capably handle.

Finally, attached to this report are a number of appendices. Each represents an individual item the subcommittee was asked to obtain for review by the incoming administration. The current departmental administration was particularly helpful in putting this information together and most of it can be found in the transition memo drafted by DOBI and submitted to the subcommittee on December 3, 2009. Additionally, a list of all individuals with whom the transition team met, from departmental officials to regulated industry representatives and company executive is also attached.

## **DEPARTMENT OVERVIEW**

DOBI in its current form was created in 1996 pursuant to P.L.1996, c.45 (N.J.S.A. 17:1-13 et seq.) when the Department of Banking and Department of Insurance were merged as a cost savings measure by Governor Whitman. In its current form, DOBI regulates the banking, insurance and real estate industries in a professional and timely manner that protects and educates consumers and promotes the growth, financial stability and efficiency of these industries.

### Banking

The Division of Banking is currently accredited by the Conference of State Bank Supervisors (CSBS) and licenses and regulates state-chartered financial institutions, currently numbering 88 banks and 19 credit unions. These duties include overseeing the financial solvency of these approved financial institutions while also enforcing actions against those in violation of the Department's regulations. Additionally, the Division regulates licensed lenders, which range from check cashers and pawnbrokers to debt adjusters and motor vehicle installment sellers. The Division currently employs 86 individuals in four units.

### Insurance

The Division of Insurance is currently accredited by the National Association of Insurance Commissioners (NAIC) and regulates the state's insurance industry, including the life, health, and property & casualty insurance industries. While in recent years the constituencies affected by the Property & Casualty Bureau have been largely pleased with DOBI's operations, industry concerns have grown regarding the operations of the Life & Health Bureau. Among these tasks, the Division oversees the solvency of the various companies and ensures consumer protections while periodically examining the licensed entities within the industry for compliance issues. Additionally, the Division licenses and regulates insurance agents and brokers (producers). The Division currently employs approximately 330 individuals in four units.

### Real Estate Commission

The Real Estate Commission ensures that members of the real estate industry comply with existing laws and regulations. When violations are suspected, the Commission investigates these claims and either resolves them or conducts hearings concerning the violations. Additionally, the Commission registers all licensed brokers in the state and inspects their operations and offices. The formal Commission consists of 8 members (7 appointed by the Governor and one government representative) that conduct hearings related to potential violations.

## CURRENT CONDITIONS

### Banking

Solvency of banks is currently the number one area of concern for the Division of Banking. While more than 140 banks have failed nationwide since early 2008, only two have failed in New Jersey. However, DOBI believes that two banks may fail in the coming quarter due to commercial lending that in retrospect was riskier than it appeared at the time. An additional 17 state-chartered banks are currently on what DOBI terms the “watch list;” they are financial institutions that are not of immediate concern but need to be closely monitored to ensure their financial stability. If any of these banks are considered at risk to fail, the Division of Banking will work with the Federal Deposit Insurance Corporation (FDIC) to ensure that an acquisition of an at-risk institution is completed by a well-capitalized institution prior to failure.

What has most complicated the Division’s efforts and ongoing mission is the recent retirement of a number of experienced regulators following Governor Corzine’s early retirement initiative (See *Problems* for more general details) which left the Division with fewer bodies than it needs to operate capably. This includes the departure of several experienced regulators, particularly within this division. The federal government’s recent shift from 18 month inspection cycles to 12 month inspection cycles may exacerbate this issue.

The ability of banks to “flip” their charters from state to federal is also of concern. As regulatory services do not meet the expectations of the industry funding this Division, the industry may be inclined to examine other regulatory alternatives. While it is evident that New Jersey financial institutions prefer a local state regulator, if services do not meet expectations, de novo banks may be inclined to seek a federal, rather than a state charter. While this costs banks a greater amount, the more lax regulatory structure of a federal charter may make up for the added up front costs. This is a choice that more banks may consider if DOBI’s regulatory activities are not sufficient. This will further hinder DOBI as a reduction of assessments will further limit its ability to adequately fund and staff the Division.

Without the enactment of interstate de novo banking at the state level (A-3668/S-1903 in the 2008-2009 session), this problem may be exacerbated. De novo banking is the practice of expanding a bank’s physical presence by operating branches in jurisdictions beyond the home state in which the bank is chartered. De novo banking represents an opportunity to make the New Jersey state charter more valuable as banks chartered in New Jersey will be able to expand their operations to 22 other states. However, as a double edged sword, if DOBI does not meet the industry’s expectations, banks may choose to re-charter in another state that they believe provides them better services for the fees they pay.

Currently, the Division is promulgating regulations to implement the New Jersey Residential Mortgage Lending Act (P.L.209, c.53) in accordance with the federal Secure

and Fair Enforcement (SAFE) for Mortgage Licensing Act of 2008 (12 U.S.C. 5101). Even upon promulgation of these regulations to maintain regulatory oversight of the industry at the state level, with the CSBS' upcoming accreditation of the Office of Consumer Finance, the positions of Assistant Director of Banking and two chief examiners must be filled to ensure that accreditation is granted, or New Jersey still risks losing its regulatory oversight of mortgage lending to the federal government. The timeliness of these regulations can not be understated as failure to adopt them before July 2010 places New Jersey at risk for losing state regulatory oversight of this industry as it currently exists.

### Insurance

- Health – The health insurance marketplace is the least stable of the areas regulated by DOBI. However, it must first be understood that the State regulates only approximately 30 percent of the health insurance market. This represents covered lives in the Individual Health Coverage Program (IHC), the Small Employer Health Program (SEH) and large group plans with greater than 50 individuals. All other insured lives are found in the large group employers or self-insured funds, which are exempted by the federal Employee Retirement Income Security Act of 1974 (ERISA; Pub.L. 93-406; 29 U.S.C. 1001). This means that whatever steps are taken to reduce health insurance costs at the state level, will only apply to these regulated marketplaces. What this also means is that as additional costs are placed on the system at the state level, it is these 30 percent of insured residents who bear the largest financial burden. Currently, employer provided healthcare at the state level is approaching \$8,000 an individual per year.

Of great concern, and what has been described by some as the problem with no light at the end of the tunnel, are payments to out-of-network providers. This is best highlighted by the recent decision of Bayonne Medical Center, which has severed in-network relationships with four of the five health insurance carriers in the state, and the explosion of ambulatory surgery centers throughout the state in recent years\*. Out-of-network providers are not capped at in-network reimbursement rates. This leads to higher health care bills even if health insurers negotiate the cost downward, which is done on a case-by-case basis, still routinely exceed in-network health care costs by multiples. Providers' choice to waive copayments and deductibles for patients appears to further undermine the system. Additionally, as costs increase for the system, they eventually increase for the consumer. A continued proliferation of the practice of providers moving out-of-network will put inordinate strain on the health insurance marketplace. This will be compounded by the anticipated enactment of S-114/A-132 which will permit an assignment of benefits to all out-of-network providers by patients. In its current form, this bill will leave no incentive for providers to remain in-network as payments as higher rates for services will be guaranteed. As these costs grow on carriers, insureds will see premium increases which will make the current 20-

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\* Please see the memo from the New Jersey Association of Health Plans in the Appendix section for a thorough overview of this issue.

30% increase in the SEH marketplace from last year to this year seem commonplace. This directly counters a common theme echoed leading up to the election that health care costs need to be reduced through a variety of factors, not increased.

Finally, while New Jersey only has five health insurance carriers, it is unlikely that additional carriers will emerge in the near future. The state's regulatory structure, particularly as it relates to pre-existing condition exclusions and guaranteed issue make it unique in the nation. While one would be led to believe that increased competition would lead to a reduction in prices, similar to the automobile insurance marketplace, the current marketplace will not allow this to occur. As regulated as the IHC and SEH currently are, when one examines the health insurance quotes offered by all five carriers, they are remarkably within a similar price range. This overregulation of marketplace has led to an inability to create innovative health products to provide to consumers. The Legislature has limited this ability through the imposition of numerous mandates, increasing the required medical loss ratio of premiums, and limiting what particular products can be offered, among other things. Until New Jersey's marketplace more closely resembles the marketplaces of other states, the lack of carriers and competition will continue. One needs to look only at the automobile insurance market; once New Jersey became a functional marketplace reflecting the practices of other states, carriers emerged. Competition itself will not occur until the marketplace permits it.

- Life – In recent years, the life insurance marketplace has become an area with greater emphasis applied to it. Unfortunately, this can be attributed to the lack of new and innovative products. In other states approvals are commonplace; in New Jersey they are more commonly rejected.

While DOBI may be able to demonstrate that such rejections are not prevalent per se, the reasons for this are twofold, insurers either grow frustrated and withdraw their product at some point during the process, or forego filing their most innovative product version here, instead using a plain vanilla alternative. Agents became so frustrated by the Life Product review process that they convinced the Legislature to adopt a “40-state rule” (P.L.2001, c.237; N.J.S.A. 17B:25-18.4) by which if a form receives approval in 40 states, it may be sold here without New Jersey approval. This alternate process, while providing relief to the agents, continues to cause anxiety among some compliance professionals at national insurance companies. Additionally, the “40-state rule” is one that small and medium size companies cannot avail themselves of.

Alternative solutions exist, including enactment of the “Interstate Insurance Product Regulation Compact” (A-2614/S-1258 of the 2008-2009 session). This compact applies to life insurance, annuity products, disability income products and long-term care products. Currently, 33 states representing 54 percent of the insurance marketplace are members. Besides representing another approval

process for products, it also represents an opportunity to preserve state regulation of the insurance industry as the National Conference of State Legislatures (NCSL), the National Conference of Insurance Legislators (NCOIL) and NAIC, have all endorsed it for this reason. However, this should not be seen as the sole solution.

The industry has come under attack in other instances due to the unscrupulous practices of a small number of individuals. This is best exemplified by the Legislature's handling of variable annuity sales for seniors, a matter typically regulated at other levels, through the enactment of P.L.2008, c88 (N.J.S.A. 17B:25-34 et seq.; formerly S-1165Scs- Adler/Singer). Similarly, stranger-originated life insurance (STOLI) policies represent a growing issue where DOBI must act in a manner consistent with other state regulators. These types of lines best represents the area where DOBI's lack of desire to examine new products and an apparent belief that consumers are not educated enough to make decisions for themselves has hindered a marketplace.

- Automobile – While automobile insurance was a political hot topic from the late 1980s until 2003, due to statutory and regulatory reforms, the marketplace has stabilized in recent years. While New Jersey residents still pay one of the highest rates in the nation for automobile insurance (2<sup>nd</sup> only behind Washington, D.C.), the stabilization that has overtaken the marketplace has resulted in greater competition by carriers. It was only in April that the last vestiges of the pre-reform regulations expired, thus resulting in the first true free-market for automobile insurance in close to three decades. In fact, due to the soft marketplace that emerged and the resulting recent undercutting of prices by so many different carriers, it has become apparent that costs will need to increase slightly to account for this “price war” within the marketplace. Companies have begun to recognize this and a number have filed rate increases during the past year. In some instances, companies even filed multiple increases during this time period. Nonetheless, the Legislature's apparent decision to remain detached from automobile insurance issues has led to stability in the marketplace unparalleled in recent memory for New Jersey drivers. However, these rates must also be examined in the context of how they are calculated. NAIC computes these calculations as average rates per state per coverage. As policies in New Jersey include generous medical benefits, rates will undoubtedly be higher when compared to states without them. Similarly, as New Jersey's roads are congested with vehicles that tend to be more expensive, the resulting collision and comprehensive costs will also be higher.

The two areas that are of continuing concern regarding automobile insurance are (1) the upward pressure on rates that personal injury protection (PIP) costs create and (2) the implementation of the Territorial Rating Equalization Exchange (TREE). Regarding PIP costs, this issue appears to be partially resolved with the recent denial of cert by the State Supreme Court to a challenge against the PIP medical fee schedule promulgated by DOBI. However, the incoming

administration should remain vigilant of Legislative initiatives to redefine how the fee schedule is calculated, which could result in price destabilization. Additionally, even with the fee schedule in place, the costs associated with performing treatments at certain locations are disparately more than at other facilities and should be examined, as this may be a contributing factor to the upward pressure on rates described above. While the fee schedule represents a very good start to containing PIP costs, with some procedures still being eligible for reimbursement at three times the rate that Medicare reimburses, benefits will continue to be diminished. With consumers facing limits on their coverage, exorbitant reimbursement rates not only increase premiums, but they also exhaust coverage limits far more rapidly. This is a double problem for consumers.

Finally, following the Department's adoption of regulations for the implementation of TREE to mitigate the disparity between actuarially justified rates in urban areas and the statutory cap on those rates, the insurance industry has sued DOBI, arguing that this regulatory scheme is outside the purview of DOBI's authority. While the case was initially scheduled for oral argument on January 13, 2010, it was recently adjourned while the industry and DOBI negotiate possible mechanisms that will trigger the use of TREE. Due to the current lack of meaningful statistics to indicate any substantial reduction in urban automobile insurance policies since the expiration of the "take all comers" requirement, TREE appears to be a solution in search of a problem. Unlike the past, there is no assigned risk marketplace to provide coverage for good drivers in specific geographic areas if insurers decline to offer the, voluntary market coverage. TREE may be a solution; however, there may be other, better solutions that have not been examined and need to be considered. It will be up the incoming administration to decide whether the current regulatory system provides protections to urban consumers without imposing a new layer of regulations and subsidizations. In any event, the incoming administration will have to deal with this issue, particularly if urban insured numbers decline, signaling that insurers are pulling out of certain areas.

- Homeowners – Historically, the homeowners' insurance marketplace has represented the most stable line of insurance in the state. However, in recent years, historically low rates have increased following the storm seasons of 2004 and 2005. While rates have increased, costs for coastal areas have remained average when compared to other states by NAIC. A trend that needs to be explored though is certain companies decisions to rate the entire state, including the mountainous regions of northwest New Jersey as coastal. In addition, while some larger companies are in the process of conducting block non-renewals, other smaller, specialized companies have emerged in the marketplace in addition to surplus lines carriers. Even so, there should be a goal of maintaining as many large carriers in the admitted marketplace to continue providing consumers with greater choices.

## Real Estate

With the recent downturn in the real estate market, licensed brokers are under greater scrutiny than in the past. This could be due to any number of factors, the most obvious being that an increased number of complaints could be being filed against brokers, whether they are in violation of the law or not, by unsatisfied consumers. However, at the same time, the Commission has reduced the average open time of a case from approximately six years to less than two. While this represents an improvement, the question remains whether a 20-month average turnaround is acceptable. Until the real estate market stabilizes, it will be difficult to determine the true efficacy of the current setup as well as the effects the marketplace have had on the Commission's operations.

## **WIDESPREAD PROBLEMS**

The most pressing problem faced by DOBI is the recent loss of a large number of experienced staffers. Governor Corzine's early retirement initiative (P.L.2008, c.21; formerly S-2044Aca – Turner) not only reduced the size of DOBI by encouraging the retirement of senior regulators, but it also reduced the available number of staff positions within the Department to handle the matters for which it is responsible. The early retirement initiative contained a backfilling provision that permitted only one person to replace every 10 who opted to retire. Much of DOBI is reliant upon employees with long-term institutional knowledge. As 32 individuals opted to take part in the program, including the Director of Insurance and the Assistant Director of Banking, this led to a significant reduction in not only staff, as only three new hires were permitted with the 10 to one backfilling provision, but also in regulatory knowledge. Since employees were required to have 25 years of creditable service to take advantage of this program, this essentially denuded the Department of its most senior and experienced staff. This is most evident in the Division of Banking where currently three key positions need to be filled in the immediate future to ensure that the Division retains its current accreditation from CSBS as well as gains an additional accreditation for regulating mortgage-lending activities.

The freeze on hiring, even though the Department is self funded, has also resulted in numerous individual's being moved into jobs for which they are not trained, or worse, not even qualified. Examples of this would be clerical staff being moved to investigative units, even as the Department is currently merging such units across its three industries of oversight.

Compounding this dilemma is the issue of compression, where unionized workers, due to negotiated annual wage increases, are earning more salary than their respective managers and supervisors, who do not receive annual increases. Due to unionized employees' ability to earn a higher income, at a level of less professional responsibility, it has become difficult to promote long time workers to managerial positions. This is a direct result of individual's reluctance to accept a lower salary at a senior title. It has also made

it more difficult to maintain morale among managerial staff that are currently doing higher level work, yet earning less than their subordinates due to union contracts. This further inhibits the Department's ability to cultivate institutional knowledge throughout its managerial ranks, as unionized employees with years of expertise have refused to be promoted to leadership positions.

The issue of furloughs is also of significant impact to the Department. Governor Corzine instituted furloughs in 2009 as a way to close the ever increasing budget deficit, initially requiring all state employees to take one day a month, before it was negotiated down to a total of seven days for FY2010. This was seen as a cost savings measure that would result in decreased salary expenditures for the State; however, as DOBI is industry funded, no savings were seen, as a portion of each company's assessment was returned to the companies due to furloughs. This shortsighted measure similarly hampered other agencies such as the Department of Labor and Workforce Development and the Department of Agriculture, both of which receive substantial federal funding, as well as the Casino Control Commission, which is also funded by fees paid by the industry it regulates. Each of these three problems has compounded the others, resulting in particularly low morale within DOBI. Beyond the morale problem, though, is the significant productivity problem in this Department, which through its approval functions, is positioned to spur innovation and development in the industries it regulates.

From the industry perspective, the first and third of the above-mentioned problems has become most troublesome. Each of the regulated industries had previously agreed to fund DOBI's activities through special assessments to guarantee that the Department could continue to operate as a highly effective and efficient regulatory agency. This is on top of the business taxes the State already imposes upon these industries that go directly to the General Fund. Unfortunately, staff reductions and furloughs prevent staff from accomplishing their jobs, as one would expect. Examples of this are the regulated industries funding a certain number of positions, while those same positions are being eliminated for the purpose of political gain by individuals to claim that they have reduced the size of government or when regulators do attempt to operate as they are designed to, they must cut corners or be diverted to other projects. The funding industries could make a very strong argument that they are paying for services they are not receiving, akin to taxation without representation.

The other industry complaint that has come to light is what can be described as "staff experience versus staff entrenchment." Staff experience can be summed up through the previous descriptions of a more senior staff with years of regulatory knowledge that are well regarded among the industry. Counter to this, staff entrenchment is the decisions by some of these same individuals that limits innovation within the marketplace and leads some companies to conduct less business here than one may expect. It appears that with this highly regarded regulatory experience has come also a regulatory mindset where what currently works is permissible, while innovation should be limited; similar to an overbearing paternalistic relationship. DOBI's rigidity in its decision making process can best be summed up through the saying "We do it this way because we've always

done it this way.” This lack of innovation within the mindset of DOBI is reflected through the lack of diversity of approved products.

As the Department’s interaction with the Administration is concerned, currently, it appears that the decision making process originated from the Governor’s Office of Policy and Planning, where technical expertise is limited, rather than within the Department. This appears to be the reason why many policy decisions were politically motivated, rather than motivated by any actual pressing issue. This organizational setup limited not only DOBI, but other departments in pursuing worthwhile policies during the past four years.

From a business development point of view, while a number of banks are domiciled in the state along with a number of carriers writing various lines of insurance in the state, many federally chartered banking institutions and carriers in the insurance marketplace do not have sizeable New Jersey operations. Even certain domiciled companies have begun reducing staff numbers, or moving them to operations out of state. The common complaint that emerged is that New Jersey is not friendly to business. This ranged from the general business climate that pervades the state to the attitude that business represents revenue opportunities to the state, rather than economic growth opportunities. Additionally, regulations promulgated by other departments affect the bottom line and ability to construct capital facilities within the state more so than DOBI’s oversight. The subcommittee believes that even though the Red Tape Review is examining these issues separately, the concerns of the industries need to be raised.

## **GOING FORWARD**

In the future, DOBI and its staff should continue its role as a regulatory agency, while restricting its policy-making activities to an as-needed basis. In instances where policy-making is warranted, staff within the Department should be amenable to working with the interested parties, particularly the industries it regulates, to understand fully the implications of any policy initiatives prior to issuance. Similarly, while it is necessary to maintain a highly experienced and knowledgeable regulatory staff, individuals should be willing to rely on the industry for more input as it already is the primary source for much of the information that the Department relies on in making these types of decisions.

## **RECOMMENDATIONS**

While the majority of the subcommittee’s activities revolved around examining the current operations of DOBI, the subcommittee also considered structural changes that should benefit either DOBI or the respective divisions within DOBI. Some of the recommendations will undoubtedly be easier to implement than others; however, all should be considered as the subcommittee believes they represent opportunities to either consolidate services among departments or the more efficiently provide services within current limitations.

## Funding

As repeatedly described previously, DOBI's full operations are funded by assessments made upon the industries it regulates: banking; insurance; and real estate. As the industries regulated by DOBI have agreed to this funding arrangement based upon the expectation that DOBI would not be affected by outside budgetary issues, the incoming administration should not follow the outgoing administration's attitude of treating DOBI as a typical department funded with General Fund revenues. Instead, while certain surplus amounts are raised from activities conducted by DOBI and deposited into the General Fund, monies that are dedicated to fund the operations of DOBI should remain so.

Following this, as DOBI currently generates approximately \$40 million in profit a year, it should be examined whether a portion of this money can also be dedicated specifically to the pensions and benefits of DOBI employees. The benefits of this would also extend to morale within the Department and could also result in a higher retention rate of professionals earlier in their career with the Department who otherwise leave prior to vesting in the pension system after ten years of service. This results in a lack of experienced employees to move up within DOBI in the future, both near and long-term (See *Staffing* for more info). The subcommittee is aware of the statewide pension funding issue and believes that while specific pensions should not be protected compared to others, a potential examination of this funding source for self-funded departments may be warranted. By guaranteeing that the funds assessed upon the regulated industries are used as designed, DOBI can also alleviate the possibility of banks flipping to a federal charter, which although more expensive, provides them greater regulatory leeway. Not only does this place them outside the regulatory purview of DOBI, but it also reduces the funds available to maintain ongoing DOBI operations. Additionally, with an optional federal charter being discussed at the national level for insurers, a similar problem could arise in the near future.

Funding should also be used to upgrade internal technology (IT) systems within DOBI to consolidate the numerous systems in use. This streamlining should allow the Department to meet the technological requirements necessary to operate in a more streamlined fashion. There is a consensus that the Department is constrained by the lack of IT resources to evaluate the issues. DOBI has recently obtained approval to engage IT consultants and will commence a project to improve the processes within the division, but this approval took more than half a year to obtain.

Finally, as DOBI is funded through an industry assessment, and not the General Fund, the necessity for continued furloughs of DOBI employees should be examined. Furloughs of employees at agencies funded through regulated industries do not result in any cost savings, but rather result in lost revenue. This is similar to the situation faced by the Casino Control Commission (funded by casino revenues) and the Board of Public Utilities (funded by utilities).

## Staffing

Supplementing the staffing issues mentioned above, another solution to maintaining a quality staff at DOBI and combat morale issues is to counter the issue of salary compression where unionized employees are currently making a higher salary than non-unionized managers/supervisors. Upon being promoted to a manager position, employees lose the automatic wage increases that come with being a unionized employee. For employees who choose not to become managers, as annual wage increases that are negotiated occur, they can eventually earn more than their supervisors. Future contract negotiations with unions should terminate this practice by eliminating wage increases for union employees when any increase will provide them with greater compensation than their supervisors. This should also lead to an easier ability for DOBI to internally promote employees since for individuals to earn a higher salary, they will have to take a higher paying job with more responsibility, thus earning their pay increase. Management salary grades should also be reviewed to see if they are competitive when compared not only to the private sector, but also to lower level positions within the Department.

Additionally, interviews indicated that in the past, staffers were tagged as “future leaders” early in their career, a practice that has not continued recently. These employees were ones that DOBI supervisors felt would excel in the future and be able to fill the role of leaders within DOBI. By reinstating this program, exceptional employees, whether young and recently out of school, to seasoned industry professionals who have joined the public sector, could be targeted and groomed to take over as more experienced employees retire in the near future. This also represents yet another opportunity to improve morale by providing employees within DOBI the opportunity of being noticed for their talents and subsequently rewarded.

Future staff that will need to be brought into the Department in the near future, whether due to attrition or hiring needs for accreditation purposes, must be placed appropriately to allow the Department to be smartly staffed. As staffing should be commensurate with the funding provided to the Department through industry assessments, the addition of more and better individuals as time proceeds will result in additional revenues from regulated activities. Qualified individuals are available from within the regulated industries as well as other non-state regulatory agencies.

Finally, a clear chain of command should exist from the Commissioner down past the Directors throughout the entire Department. Complaints that there is a lack of direct reporting to certain Directors, as well as an inability to implement policies due to organizational structure should not occur. A clear flow chart needs to be implemented with all individuals within a Division being able to be held accountable to the respective Director. A thorough evaluation of the operations process should be performed by the Commissioner appointed by the incoming administration to determine the best course of action to resolve the ongoing issues prior to commencement of any improvement plan. Of particular note, the prior structure where a chief of staff was present to conduct special projects for the Commissioner should be reinstated.

## Health Insurance

DOBI must take a strong look at ways to contain the burgeoning issue of out-of-network insurance costs. As out-of-network usage increases, health care costs continue to expand, making it more difficult for employers to provide it and individuals to purchase the benefit. Possible solutions that should be examined are:

- imposing a fee schedule for out-of-network costs;
- setting up a dispute resolution system outside of the current arbitration system to impose a greater degree of cost effectiveness; and/or
- re-examining how carrier and providers negotiate contracts to find a method that will encourage greater in-network participation while providing adequate compensation for services.

Additionally, as federal health care reform is being undertaken by Congress, the Department should examine the methods to make more affordable health insurance available to a greater percentage of the population, similarly to how the Legislature created the Basic and Essential Policy in 2001 (P.L.2001, c.368). This policy is significantly less expensive than typical health insurance policies offered in the state. This should include working with the Legislature to expand eligibility for this type of policy by eliminating the barriers that currently prohibit groups of individuals, such as those eligible for more expensive plans, from purchasing this coverage. This proposal mirrors Governor-Elect Christie's during the campaign to make more affordable health care options available. At the same time, certain controls should be placed on these policies that will prevent actions such as adverse selection by carriers; however, it should not be as heavily regulated as the IHC or SEH markets, which has resulted in exorbitant premiums and only five companies currently offering plans in the state.

The state should also move the health marketplace in the direction of other states, both through the Legislature as well as DOBI. As New Jersey sets itself apart from the majority of other states, carriers have less of an inclination to do business here. For the benefits of consumers, any shift from the current market dynamics would be more than welcome. The price disparity between typical health insurance policies and policies available through the Basic & Essential Policy illustrates this point due to its wider range of rating factors.

## Real Estate Commission

When examining how other states regulate their real estate licensing process, it has become clear that the majority of them conduct it through their respective Division of Consumer Affairs. The primary reason that the Real Estate Commission exists within the Division of Banking is due to the prerogative of the Whitman Administration when merging the Department of Banking with the Department of Insurance. As New Jersey begins implementing continuing education credits for real estate agents, the last state to do so, it should also bring itself in line with other states and shift the Commission to the Division of Consumer Affairs within the Office of the Attorney General. Currently, most

regulation of licensed professions, similarly to the real estate industry, is currently located within the Division of Consumer Affairs. As the Real Estate Commission is classified in Title 45, so are many of these other professions, appearing to make the Division an appropriate location. As the Division currently handles licensing, complaints and enforcement actions, these tasks could easily be absorbed.

Additionally, in line with standardizing how other states regulate the real estate industry, New Jersey should permit the ability of non-active licensees to maintain their license for an extended period. All 49 other states provide this service for a fee, which New Jersey should consider. As real estate licenses currently last for a two year period, the non-active period should be a multiple of this; either six or eight years. Currently, there are approximately 60,000 non-active licensees in the state and this new service that can be provided within existing staff limitations, represents a revenue source for the state. This should not be construed as a tax as this will be a new service that real estate licensees have been inquiring about for years and would satisfy this request. At the same time, any fee must be justified as competitive as New York charges no fee for this option.

It has also been reported that Commission meetings have been conducted mostly outside the eyes of scrutiny by the public, with most actions occurring in executive session. While minutes are required to be produced from these executive sessions, none have been from what can be found. Additionally, as all decisions appear to be made during these sessions, the reasoning behind many of the decisions is unknown. Future meetings should be more open so that more of the process is deliberated. Additionally, the Commission should begin to use consistency in its rulings. While it is understandable that quasi-judicial decisions may be harsh, there should be consistency among the decisions where similar violations are not punished with disparate penalties.

Finally, the current Commission membership and salaries attached to the positions should be examined. The seven commissioners appointed by the Governor currently collect a total of \$75,000 in the aggregate a year in salary pursuant to N.J.S.A. 45:15-6, as well as the resulting pension credits and benefits. While members terms are three years pursuant to statute, N.J.S.A. 4:15-5 also provides that the successors should not be appointed until their current term expires. This is of particular interest due to the outgoing Governor's decision to reappoint the Commission chairman prior to the expiration of his term. The statute further declares that the Governor "may remove any commissioner for cause," for which this may qualify. The incoming Governor should replace the entire commission with members who will be willing to serve without compensation, or at least qualify for a pension, even in light of their statutory ability to collect it, or to line item veto any money for commissioners' salaries in the annual appropriations act. Discussions should be engaged with interested parties to discuss possible interested parties to fill the broker roles, while public members who express an interest in serving without compensation should also be considered for the two public positions.

## Bureau of Securities

Just as the mission of the Real Estate Commission can be best fulfilled by moving it from DOBI to the Division of Consumer Affairs within the Office of the Attorney General, the mission of the Bureau of Securities can be best fulfilled by moving it from the Office of the Attorney General to DOBI. This change would enhance the regulation of the financial services industry by housing a comprehensive, coordinated, efficient, and modern regulatory structure for the industry in one Department. In any economic environment, but particularly as the business climate in New Jersey has chilled over the last several years, multiple state regulators for a single product or profession is an example of the red tape that drives business away. The addition of the Bureau to DOBI would eliminate duplicative regulation and streamline business processing.

Currently, the Bureau of Securities administers the New Jersey Uniform Securities Law (N.J.S.A. 49:3-47 et seq.) and the corresponding regulations (N.J.A.C. 13:47A-1.1 et seq.). The Bureau's regulatory oversight includes broker-dealers (brokerage firms), broker-dealer agents (stockbrokers), investment advisers, investment adviser representatives, agents of securities issuers, securities registrations, security exemptions, mutual funds and unit investment trusts. The Bureau's regulatory staff issues no-action relief and interpretive guidance to regulated entities. Additionally, a field examination staff exists that conducts routine and for-cause examinations. Finally, investigative staff examines possible violations of the relevant laws and regulations.

Nationwide, states regulate the securities industry through a variety of different administrative agencies. There are chiefly four state level departments that other states use to regulate their respective securities industries: the Department of Insurance/Banking/Finance; a specialized securities department; the Attorney General; or the Secretary of State. The bulk of these states use their equivalent to DOBI to regulate securities due to the similarity in products available and the providers of such. As such, the operations of the Bureau of Securities should be consolidated within DOBI as the similarity in their mission and product oversight make this an ideal shift of operations. Similarly, this would permit the consolidation of the operations of the agencies that approve certain products and subsequently regulate those same products.

## TREE

As mentioned earlier, TREE may be a solution to what could be a future problem pertaining to the availability of urban automobile insurance, but it is in no way the only solution. DOBI should examine alternative solutions for this possible problem and provide them to the incoming administration within three months. As the Department is currently in litigation regarding this issue, providing alternatives that fit within the current regulatory system that are more amendable to the affected constituencies may be used as an incentive in negotiations to terminate the lawsuit.

## Attorney General

Just as DOBI's operations are entirely funded by the industries that it regulates, the same remains true for deputy attorneys general who conduct work within the Office of the Attorney General on these issues. In recent years, in line with Governor Corzine's decision to simply attempt to reduce raw numbers, rather than eliminating positions that have become either outdated, or filled with political appointees, industry funded positions such as these have been eliminated. Similar to how DOBI's formal operations have resulted in the industry paying an assessment yet receiving fewer services, the same can be said regarding support by funded individuals within the Office of Attorney General.

Going forward, additionally deputy attorneys general, as funded through the industry assessment, should be dedicated to activities related to DOBI. These individuals bring in more revenue through the issuance of enforcement actions against entities in violation of the law than cost the industry to fund them. Similar situations within other industry-funded agencies should also be examined and considered.

## Office of Insurance Fraud Prosecutor (OIFP)

While communications between the Office of the Attorney General and DOBI needs to be improved, the overall interaction between the two needs to be overhauled. The Office of the Insurance Fraud Prosecutor (OIFP) represents \$33 million, or 47.5 percent, of the entirety of DOBI's annual budget. However OIFP's record of prosecuting cases has not reached the level one would expect from that level of funding. Cases that have been described as a "slam-dunk" by special investigative units of insurance companies as well as DOBI have languished with little or no action for years. Both the industry and regulators indicate dysfunction within OIFP's operations; however, there is no singularly agreed upon solution.

While it is clear that the office is not functioning properly, the lack on unanimity throughout the industry on how to handle OIFP's operations has left the subcommittee with the opinion that the incoming administration closely examines the operations of OIFP and its interaction with DOBI. Following this examination, the administration should consider one of the following options:

- transferring the operations of OIFP to directly within DOBI, including the relocation of attorneys and prosecutors;
- requiring greater interaction between the Attorney General and the Commissioner of DOBI to ensure that resources funded by DOBI, and the assessment made upon the insurance industry, are used properly and more effectively; or
- considering making OIFP a separate entity that does not report to either the Attorney General or DOBI, but continues to receive its funding from the current assessment on the insurance company, to ensure that it only conducts insurance investigations.

Regardless of any structural changes affecting OIFP going forward, benchmarks should be established that must be met for every case handed to the office. These benchmarks

must be effective, timely and measurable. Finally, the consideration of how costs associated with OIFP can be reduced, while also maintaining an effective operation under any of the three above proposals should be paramount.

### Captive Insurance

A new insurance line that the state may want to pursue, is the licensing and regulation of captive insurers; insurers that finance risks emanating specifically from their parent group or groups. Currently, 25 states and the District of Columbia permit captive insurers to be formed within their borders, with Vermont being viewed as the state model with the best design. This will serve two purposes. The first is that it will signal that the incoming administration believes New Jersey companies should be able to insure their risks in New Jersey, demonstrating a true “open for business” attitude; the second is that additional revenue can be derived from the operation of this new industry in the state as other states have used captive insurers as economic drivers. Current legislation, S-387 – Gill, does exist and permits captive insurers to operate in New Jersey and is modeled after Vermont’s captive insurer law.

### Interaction

More effective interaction must occur between DOBI and the Governor’s office. While the Governor is the chief policymaker in the State, the Governor’s Office of Policy and Planning should not be developing policies for departments to implement based upon political whims. Outgoing Governor Corzine’s policy shop placed voter constituency as the primary reason behind promoting public policies. This set up placed many departments, not only DOBI, at a disadvantage from recommending and initiating public policy in line with their mission. Rather, public policy was dictated by politics. Going forward, decisions should examine whether a policy represents a good idea or a bad idea in terms of the long term interests of the state before addressing its merits for certain classes of residents. Additionally, when policy objectives are set, DOBI should assist the Governor’s office in implementing them.

### **Conclusions**

With the incoming administration dedicated to improving the efficiency of state government, this transition represents a unique opportunity to reform the operations of all departments. Particularly unique is DOBI due to its industry-funded nature. All operations within the Department are funded by the regulated industries with all additional revenues being dedicated to the General Fund, resulting in funding being directed to other departments.

As such, the Department’s operations should be examined in this context and not as simply part of state government as a whole. Across the board cuts that eliminate wasteful spending in certain departments only hinder DOBI’s ability to effectively regulate and permit business innovation. Similarly, these cuts impact DOBI’s ability to operate as a revenue raiser in the instances where this possibility exists. Any decisions made

regarding DOBI's ongoing or future operations needs to be made in this context and removed from the political winds.

DOBI's status as a self-funded entity should not be construed as an acceptance of the status quo though. There is an opportunity for the incoming Commissioner to make a serious review of the internal organizational structure of DOBI and establish "smart staffing" guidelines. As structural changes permit, DOBI must aim to improve the regulatory services it provides to the industries and consumers of the state, in a smarter, more efficient manner.

DOBI generally represents what most departments in state government should strive to be: an efficient, highly professional department. This ongoing transition represents an opportunity to highlight the successes found in the Department, while correcting areas of concern.