Consumer Federation of America

STATEMENT OF
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BEFORE THE COMMITTEE ON
COMMERCE, SCIENCE & TRANSPORTATION
OF THE U.S. SENATE

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"STATE OF INSURANCE REGULATION"

Insurance regulation is at a crossroads. Most states are rolling back insurance consumer protections and weakening their oversight of the industry, while pressure from some insurers is growing for increased federal regulation. Some powerful elements of the insurance industry want to be allowed to choose either federal or state oversight (e.g., ACLI, AIA, banks selling insurance). Under such an "optional federal charter" plan, if the federal government actually effectively regulated, these companies would be allowed to retreat to state regulation. Other elements of the industry favor no federal role at all, except bailouts such as the Terrorism Risk Insurance Act (e.g., NAII, AAI, NAMIC).

While insurance companies disagree on the need for federal regulation, they are unanimous in their desire to use the possibility of federal oversight as leverage to press the states to reduce extant consumer protections or hold off needed new protections. Insurers know that state regulators will want to move fast to reduce the regulatory burden (that is, the consumer protections they require) in order to hold onto some extra insurers in the regulatory turf wars that are coming. There is even talk of interstate compacts to limit regulation to one state or to otherwise "harmonize" regulation, although the states with higher standards -- the sopranos, tenors and altos -- will be asked to "harmonize" by learning to sing bass.

Few ask consumers what they think. I am therefore most grateful to you, Chairman McCain, Ranking Member Hollings and members of the Committee, for this opportunity to explain how insurance regulation can be improved to help consumers.

BACKGROUND

Insurance is regulated by the states under a remarkable delegation of authority in the McCarran-Ferguson Act. There is no insurance oversight by the federal government, nor are there standards for

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effective regulation, but there is an exemption from the antitrust law, which very few other American industries outside of major league baseball enjoy. Thus, for example, insurers routinely use rating organizations to jointly project inflation costs into the future.

Insurers have, on occasion, sought federal regulation when the states increased regulatory control and the federal government regulatory attitude was more lazes-faire. Thus, in the 1800s, the industry argued in favor of a federal role before the Supreme Court in Paul v. Virginia, but the court ruled that the states controlled because insurance was intrastate commerce.

Later, in 1943 in the SEUA case, the Court reversed itself, declaring that insurance was interstate commerce and that federal antitrust and other laws applied to insurance. By this time, Franklin Roosevelt was in office and the federal government was a tougher regulator than were the states. The industry sought, and obtained, the McCarran Act.

Notice that the insurance industry is very pragmatic in their selection of a preferred regulator -- they always favor the least regulation. It is not surprising that, today, the industry would again seek a federal role at a time they perceive little regulatory interest at the federal level. But, rather that going for full federal control, they have learned that there are ebbs and flows in regulatory oversight at the federal and state levels, so they seek the ability to switch back and forth at will.

Consumer organizations strongly oppose an optional federal charter, where the regulated, at its sole discretion, gets to pick its regulator. This is a prescription for regulatory arbitrage that can only undermine needed consumer protections.

Further, the insurance industry has used the possibility of an increased federal role to pressure states into gutting consumer protections over the last three or four years. Insurers have repeatedly warned states that the only way to preserve their control over insurance regulation is to weaken consumer protections. They have been assisted in this effort by a series of House hearings, which have not focused on legislation or the need for improved consumer protection, but have served as a platform for a few politicians to issue ominous statements urging the states to further deregulate insurance oversight, "or else." (See statements by industry representatives and Members of Congress below.)

CAN INSURANCE BE DEREGULATED?

There are good reasons that insurance has, historically, been subject to regulation. The most obvious one is that a consumer pays money today for a promise that may not be deliverable for years. That promise must be secured from many threats, including insolvency and dishonesty.

No one seems to dispute the need for oversight of insurer solvency and bad management behavior. Insolvency regulation has been upgraded, thanks in large part to the interest in the issue of Warren Magnusen and John Dingell (which is how insurers first became aware of the value of Congressional pressure on state regulators.)

As front-end regulatory controls such as price regulation have been eliminated for personal lines and small businesses by the states individually and for small businesses by the actions of the National Association of Insurance Commissioners (NAIC), consumers have been promised that back-end market conduct oversight would be improved. These promises have proven to be empty. For example when small business pricing was deregulated by the NAIC and many states adopted this approach, nothing was done to correct the hopelessly incompetent market conduct system that exists in most states. (The GAO has recently documented the failures of the state market conduct system in great detail.)

The big question is: can price and product regulation be eliminated? The insurance companies say "sure," but never discuss the potential adverse impact on consumers.

Product regulation is very important for consumers. An insurance contract is a complex legal document. Consumers cannot be asked to pick out good or avoid bad deals by reading these documents. It won't happen. If insurers are free to write any contract that they want, some sharp dealers will come in with illusory policies that look good but take away the apparent coverage in the fine print. There will develop competition to write poor products that unwary consumers will buy.

Consumers are in no rush to have bad products appear in the market, even though insurers insist that "speed-to-market" is somehow a critical issue. It makes no sense to remove front-end control of these products and wait for market conduct exams or, as is more usual, lawsuits, to clean up the mess.[2]

However, consumer groups do want efficient regulation. I, and others from the consumer community, worked very hard at the NAIC to eliminate inefficient regulatory practices and delays, even helping put together a 30-day total product approval package. Our concern is not with fat cutting, it is with removing regulatory muscle when consumers are vulnerable.

Price regulation is a complex issue. It does not suffice to say that "competition is good and regulation is bad" as insurers often do.

First of all, insurance is not a normal product like a can of peas or even an auto. One cannot "kick the tires" of the complex legal document that is the insurance policy until a claim arises, perhaps years after the purchase.

Second, the level of service offered by insurers is usually unknown at the time a policy is purchased. Some states have complaint ratio data that help consumers make purchase decisions, and the NAIC has made a national database available that should help, but service is not an easy factor to assess.

Then there is the solidity of the insurance company. You can get information from A.M. Best and other rating agencies, but this is also complex information to obtain and decipher.

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[2] There are several reasons why it is dangerous for consumers if regulators focus exclusively on "speed to market."

First, consumers, who have been victimized by such abuses as life insurance policies that promised rates of return they could not give, consumer credit insurance policies that pay pennies in claims per dollar in premium, and race-based pricing are in no hurry for such policies. Second, in some trials of product deregulation in health insurance, policies with low prices often were found to have fine print that eliminated most coverage. Third, standards to ensure fair pricing, adequate disclosure and a more honest marketplace are urgently needed and should be a part of any process for faster product approval, particularly in the era of globalization and Internet sales. Fourth, CARFRA, a voluntary organization set up by the NAIC to offer "one-stop" approval over several states, is dangerous for consumers. CARFRA lacks direct accountability to the relevant public: consumers in affected states. There is no assurance that their standards for product approval will benefit consumers. For example, if a panel made up of Montana members approves a rate or policy for use in California, then it will be difficult for California consumers to object. CARFRA must be an independent, legally authorized entity with democratic processes, such as on-the-record voting, notice and comment rulemaking, conflict-of-interest standards, prohibitions on ex-parte communications, etc. CARFRA cannot rely on the industry it regulates to provide its funding. Moreover, the same issues consumers find dangerous in CARFRA exist in the interstate compact concept.

Finally, there is the price of the policy itself. Some insurers have many tiers of prices (we have seen mare than 25 for some companies) for similar looking insureds. Online assistance may help consumers understand some of these distinctions but only when they actually apply is full underwriting conducted. At that point, the consumer might be quoted a much different rate than he or she expected. Frequently, consumers receive a higher rate, even after accepting a quote from an agent.

And, after all that, underwriting may result in the consumer being turned away.

When you shop for a can of peas, you see the unit price, all the options are before you on the same shelf, when you get to the checkout counter no one asks where you live and then denies you the right to make a purchase, you can taste the quality as soon as you get home, and you don't care if the pea company goes broke or gives much service. In short, peas are simply not insurance.

Price regulation considerations vary by line of insurance. Large commercial insureds have insurance experts, called "risk managers," on staff. They need less help from government. Individuals and small businesses may need help. They are not well informed consumers and often go into the insurance purchase decision with an odd combination of fear and boredom. They frequently go to an insurer or agent and say the something akin to "take me, I'm yours," a shopping strategy that does nothing to discipline the market price[3].

The degree of insurance regulation that is needed varies by line-of-business, something insurers often don't admit. Consider three life insurance products as an example of this fact. Term life, cash value life and credit life. We believe that the regulatory response to these three products must be different.

Term life insurance is easy for consumers to understand. If you die in the term, whatever that time frame is, your beneficiaries receive the face amount of the policy. Consumers understand this very well so coverage is not an issue. Dead is dead, so service is not much of an issue compared to, say, auto claims. Solvency may also be somewhat less of an issue, depending upon the length of the term. The decision centers on price. Excellent online price services exist (CFA's favorite is www.term4sale.com).

Because of the simplicity of the decision-making process, term insurance prices are very competitive and have fallen, year-by-year, for decades. Price regulation is not needed in this line of life insurance.

Cash value insurance is a complex product. It is, essentially, a term policy with a bank account hidden inside the product. The problem is that the industry has resisted calls for tools to help consumers more easily understand what is going on inside the policy or to create suitability requirements for its agents. It is very difficult to know exactly what part of the first year premium (if any– often, it is none) goes into the bank account. CFA's actuary, who handles our service for life insurance, tells me that even he frequently can't tell a good product without running the policy details through our computerized service to see how it works. Consumers are confused. Competition is weak. Prices have not declined in the way term prices have.

[3] Another problem with insurance is the inertia of consumers. That is, the reluctance to change carriers for even fairly large price breaks. Consumers fear that new insurers would be more apt to drop them after a claim than their old insurer. This inertia is a drag on the competitive force of consumer decisions.

For this product, prices should be subject to more control than exists today unless the industry truly agrees to stop the obfuscation and promote rules that let the consumer see what each policy is truly like.

Credit life insurance is a product sold along with a loan, such as a car loan. The car dealer may offer the coverage that would pay off a loan if an insured dies, so that this person's family would own the car outright. The problem is that consumers do not go to car dealers to buy insurance. They have not even thought about it until the dealer starts the sales pitch. If the consumer decides to buy the coverage, the consumer does not then go out and shop for an insurance company. The dealer has already done that for the consumer.

Guess what the criteria the dealer uses in making the choice of credit life insurer? The amount of the commission is, of course, the decisive factor. (Some car dealers make more money selling insurance than cars.) Prudential Insurance Company once said in a hearing in Virginia, that they did not sell much credit life insurance because "we are not competitive, our price is too low."

This purchase-of-insurance-by-the-commissioned-agent-not-the-consumer/buyer has a name: "Reverse Competition." In this line of insurance, competition drives the price up, not down.

Credit life insurance must have price regulation. States have recognized this by limiting the price that can be charged, with widely varying maxima. New York and Maine consumers pay one-fifth of the rate of Louisiana consumers, although Louisianans obviously do not die five times faster than Mainers. Even though the credit life insurers, car dealers and other powerful lobbyists have succeeded in keeping the price outrageously high in most states, at least there are caps in every state, as there must continue to be.

IS REGULATION INCOMPATIBLE WITH COMPETITION?

The insurance industry promotes a myth: regulation and competition are incompatible. This is demonstrably untrue. Regulation and competition both seek the same goal: the lowest possible price consistent with a reasonable return for the seller. There is no reason that these systems cannot coexist and even compliment each other.

The proof that competition and regulation can work together in a market to benefit consumers and the industry is the manner in which California regulates auto insurance under Proposition 103. Indeed, that was the theory of the drafters (including me) of Proposition 103. Before Prop. 103, Californians had experienced significant price increases under a system of "open competition" of the sort the insurers seek. (No regulation of price is permitted but rate collusion by rating bureaus is allowed, while consumers receive very little help in getting information, etc.) Prop. 103 sought to maximize competition by eliminating the state antitrust exemption, laws that forbade agents to compete, laws that prohibited buying groups from forming, and so on. It also imposed the best system of prior approval (of insurance rates and forms) in the nation, with very clear rules on how rates would be judged.

As our in-depth study of regulation by the states revealed,[4] California's regulatory transformation--to rely on both maximum regulation and competition--has produced remarkable results for auto insurance consumers and for the insurance companies doing business there. The study reported that insurers realized very nice profits, above the national average, while consumers saw the average

[4] "Why Not the Best? The Most Effective Auto Insurance Regulation in the Nation," June 6, 2000; www.consumerfed.org.).

price for auto insurance drop from $747.97 in 1989, the year Proposition 103 was implemented, to $717.98 in 1998. Meanwhile, the average premium rose nationally from $551.95 in 1989 to $704.32 in 1998. California's rank dropped from the third costliest state to the 20th.

I can update this information through 2001.[5] As of 2001, the average annual premium in California was $688.89 (Rank 23) vs. $717.70 for the nation. So, from the time California went from reliance simply on competition as insurers envisioned it to full competition and regulation, the average auto rate fell by 7.9% while the national average rose by 30.0%. A powerhouse result!

STATE REGULATORY/LEGISLATIVE FAILURES

Compare the outstanding improvement in consumer protection in California with the collapse of regulatory resolve at the national, NAIC level. Here is a small sample of NAIC failures and consumer protection rollbacks:

Failures To Act

1. Failed to do anything about abuses in the small face life market. Instead, they adopted an incomprehensible disclosure on premiums exceeding benefits, but did nothing on overcharges, multiple policies, or unfair sales practices.

2. Failure to do anything meaningful about unsuitable sales in any line of insurance. Suitability requirements still do not exist for life insurance sales even in the wake of the remarkable market conduct scandals of the late 1980s and early 1990s. A senior annuities protection model was finally adopted (after years of debate) that is so limited as to do nothing to protect consumers.

3. Failure to call for collection and public disclosure of market performance data after years of requests for regulators to enhance market data, as they weakened consumer protections. How do you test if a market is workably competitive without data on shares by zip code and other tests?

4. Failure to do anything as an organization on the use of credit scoring for insurance purposes. In the absence of NAIC action, industry misinformation about credit scoring has dominated state legislative debates. NAIC's failure to analyze the issue and perform any studies on consumer impact, especially on lower income consumers and minorities, has been a remarkable dereliction of duty.

5. Failure to address problems with risk selection. There has not even been a discussion of insurers explosive use of underwriting and rating factors targeted at socio-economic characteristics: credit scoring, check writing, prior bodily injury limits, prior insurer, prior non-standard insurer, not-at-fault claims, not to mention use of genetic information, where Congress has had to recently act to fill the regulatory void.

6. Failure to do anything on single premium credit insurance abuses.

7. Nothing has been done on redlining or insurance availability or affordability. The vast majority of states no longer even look at these issues, 30 years after the federal government

[5] State Average Expenditures & Premiums for Personal Automobile Insurance in 2001, NAIC, July 2003.

issued studies documenting the abusive practices of insurers in this regard. Yet, ongoing lawsuits continue to reveal that redlining practices harm the most vulnerable consumers.

Rollbacks Of Consumer Protections

1. The NAIC pushed through small business property/casualty deregulation, without doing anything to reflect consumer concerns (indeed, even refusing to tell us why they rejected our specific proposals) or to upgrade "back-end" market conduct quality, despite promises to do so.

2. As a result many states adopted the approach and have rolled back their regulatory protections for small businesses. Nebraska and New Hampshire joined the list of states that have deregulated just this year.

3. States are rolling back consumer protections in auto insurance as well. Just this year, New Jersey, Texas, Louisiana, and New Hampshire did so.

4. The NAIC just terminated free access for consumers to the annual statements of insurance companies at a time when the need for enhanced disclosure is needed if price regulation is to be reduced.

NCOIL: At the Insurance Industry's Beck and Call

As bad as the NAIC and some state regulators have been, the National Conference of Insurance Legislators is worse. NCOIL is directed by a significant number of legislators who work for the insurance industry.[6] On several issues that are currently being debated in Congress and the states, NCOIL has offered recommendations that would negatively affect many insurance consumers, recommendations that often mirror insurance industry proposals.

For example, on May 6, 2003 Illinois State Senator and insurance agent Terry Parke offered Congressional testimony on NCOIL's proposals to improve oversight of "market conduct" abuses by insurance companies. Parke's written testimony did not comment on the state regulatory failures that led to well-known market conduct abuses that cost consumers millions of dollars, such as the infamous life insurance market conduct abuses by the nation's largest insurers such as Prudential and Met Life. Instead, Parke offered recommendations that would allow insurance companies to "self certify" that they are complying with market conduct requirements and would largely restrict oversight of insurance companies to the state where the company is headquartered.

In the wake of the Enron and WorldCom scandals, we are astonished that NCOIL would propose allowing insurance companies to essentially regulate themselves. Even worse, NCOIL proposes to put the state that is most subject to political pressure – the state where an insurance company is based – in charge of market conduct regulation for that company.

NCOIL has also offered model legislation on the use of credit scoring for insurance purposes, which has been adopted by several states. The legislation would allow insurers to continue to use credit scores to grant insurance policies and establish rates, even though serious concerns have been

[6] "Many State Legislators Involved with National Insurance Organization Have Close Ties to Insurance Industry," CFA, 07/09/03 (at www.consumerfed.org).

raised about the logic of using credit history to predict consumer accident propensity (why would getting laid off in a recession make a person a bad driver?), the inaccuracy of these scores, and the disproportionate impact that this practice has on low income and minority consumers. NCOIL's model bill would only ban the use of credit scoring if it is the sole factor used in the underwriting or pricing of insurance, which means that the bill offers no protection, as credit scoring is never the sole factor used for these purposes.

The NCOIL credit-scoring bill was developed at the behest of the industry, which realized that real reform might emerge as consumers across the nation expressed outrage over higher prices due to consideration of irrelevant credit histories. The NCOIL vote on this was telling. Members from five states (MI, NY, VT, ND and LA) accounted for 60 percent of the vote. Members from North Dakota represented 8 percent of the vote (its population is 0.2 percent of the national population). At least seven of the 25 members on the NCOIL committee that proposed this legislation are employed by the insurance industry. The vote does not appear to be representative of much other than insurer wishes.

While not every proposal NCOIL offers is anti-consumer, many are. Other examples of recent anti-consumer moves by NCOIL include:

- After years of effort, consumer groups persuaded the NAIC to adopt a credit personal property insurance model bill with a 60 percent loss ratio standard, which is necessary because credit insurance is added to a sale of some other products with huge, often hidden commissions being paid to the seller. Because the seller selects the insurer, not the customer, credit insurance suffers from "reverse competition," driving prices up. Thus a loss ratio limit is vital to control cost. A short time after NAIC acted to control the loss ratio, the industry went to NCOIL, which had never worked on the issue, and got them to issue a resolution opposing the loss ratio standard. If NCOIL prevails, consumers who purchase this form of credit insurance will pay millions of unnecessary dollars.

- Consumers requested that NCOIL adopt a consumer participation program, like that sponsored by NAIC, in which a few consumer representatives can come to the meetings to present consumer positions. NCOIL would cover participants' expenses, with consumer groups supplying the time of their advocates. Not only did NCOIL reject this mechanism for allowing consumer input, they also voted down the more modest measure of waiving registration fees for consumers, effectively shutting out all consumer input from their meetings.

- NCOIL adopted a property/casualty insurance regulatory model bill that is intended to cut consumer protections by reducing regulatory authority. The model goes so far as to say that the model should not be adopted if a state has gone even further in removing consumer protections than the bill proposes, i.e. the model is only recommended for use when it lowers protection but is not recommended for use if it raises protections. The model does not require the insurer to even file rate increases with an insurance commissioner until 30 days after it begins to charge consumers more. The commissioner, under the model, could not disapprove even an excessive rate if the market was "competitive" under a set of standards that would make a finding of non-competitiveness nearly impossible.

- NCOIL's Insurance Compliance Self Evaluation Privilege Model Act would give insurers a privilege of secrecy for anything they claim as "self-audit", effectively allowing the industry to shield itself from responsibility for its market conduct actions.

What has Caused the States to Move So Suddenly to Cut Consumer Protections Adopted Over a Period of Decades ?

In a word, "pressure," from insurers and from a couple of Members of Congress.

Industry Statements

What follows are examples of industry attempts to use the federal government interest in insurance to pressure the NAIC into action:

1. The clearest attempt to inappropriately pressure the NAIC occurred at their spring 2001 meeting in Nashville. There, speaking on behalf of the entire industry, Paul Mattera of Liberty Mutual Insurance Company told the NAIC that they were losing insurance companies every day to political support for the federal option and that their huge effort of 2000 to deregulate and speed product approval was too little, too late. He called for an immediate step-up of deregulation and measurable "victories" of deregulation to stem the tide. In a July 9, 2001 Wall Street Journal article by Chris Oster, Mattera admitted his intent was to get a "headline or two to get people refocused." His remarks were so offensive that I went up to several top commissioners immediately afterwards and said that Materra's speech was the most embarrassing thing I had witnessed in 40 years of attending NAIC meetings. I was particularly embarrassed since no commissioner challenged Mattera and many had almost begged him to grant them more time to deliver whatever the industry wanted.

2. Jane Bryant Quinn, in her speech to the NAIC on October 3, 2000, said: "Now the industry is pressing state regulators to be even more hands-off with the threat that otherwise they'll go to the feds." So other observers of the NAIC see this pressure as potentially damaging to consumers.

3. Larry Forrester, President of the National Association of Mutual Insurance Companies (NAMIC), wrote an article in the National Underwriter of June 4, 2000. In it he said, "…how long will Congress and our own industry watch and wait while our competitors[7] continue to operate in a more uniform and less burdensome regulatory environment? Momentum for federal regulation appears to be building in Washington and state officials should be as aware of it as any of the rest of us who have lobbyists in the nation's capital…NAIC's ideas for speed to market, complete with deadlines for action, are especially important. Congress and the industry will be watching closely…The long knives for state regulation are already out…"

4. In a press release entitled "Alliance Advocates Simplification of Personal Lines Regulation at NCOIL Meeting; Sees it as Key to Fighting Federal Control" dated March 2, 2001, John Lobert, Senior VP of the Alliance of American Insurers, said, "Absent prompt and rapid progress (in deregulation) … others in the financial services industry – including insurers – will aggressively pursue federal regulation of our business…"

[7] Of course, Mr. Forrester knows that this is a life insurer problem, which is not the case for his members, who are property/casualty insurance companies.

Congressional Statements

The leading Member of Congress involved in putting pressure on the states to further deregulate is House Financial Services Committee Chairman Michael Oxley. Below are some recent statements Chairman Oxley has made on the matter.

"Make no mistake about it, true reform is necessary. It is my hope that our State legislators and insurance commissioners can enact such reform. If not, Congress will return to this issue with our own solution." (Emphasis added) Opening statement at 6/2/01 Hearing, "Insurance Product Approval: The Need for Modernization."

"…why are Massachusetts and New Jersey afraid to adopt the models used successfully in Illinois and now South Carolina…" Opening statement at 8/1/01 Hearing, "Over Regulation of Automobile Insurance: A Lack of Consumer Choice."

"…price fixing and heavy anti-consumer regulations…have led to a balkanized system that can be inefficient, denies consumers choice, and is destroying the industry's competitive ability to raise capital. Today…we turn from assessing the current inefficiencies to a review of the various proposals for reform. Consensus will be difficult, but America deserves our every effort…" Opening statement at 6/4/02 Hearing, "Insurance Regulation and Competition for the 21st Century" (Day 1).

"…our American insurance marketplace is entering into a crisis…Some states fix prices below the levels to attract adequate capital…And each state imposes its own regulatory regime, creating long delays for consumers, and making it impossible for insurers to provide products uniformly nationwide...It is my primary hope that our State legislators and insurance commissioners can enact meaningful reform. The States have had some success…I would note however that this success is far from complete and has only occurred in the face of Congressional legislative pressure, pressure that will continue to grow if the pace of reform does not improve. (Emphasis added) Opening statement at 6/11/02 Hearing, "Insurance Regulation and Competition for the 21st Century" (Day 2).

"As many of you know, my interest in reform is not new. Several years ago I asked the NAIC to focus on this glaring problem and they responded in March, 2000 with a Statement of Intent…Since that time, the NAIC has experienced some successes and some failures. In the face of Congressional legislative pressure, the NAIC has made progress in agent licensing reform…Unfortunately, the NAIC has met with less success in efforts to modernize the product approval process…Unfortunately, it is becoming increasingly apparent that the NAIC may be facing an insurmountable task…this Committee will not sit idly by. I am committed to working on this issue for the long haul, looking at all the different facets of the industry. We will keep building…we will not let up…" Opening statement at 6/18/02 Hearing, "Insurance Regulation and Competition for the 21st Century" (Day 3).

"…a problem that has reached crisis proportions in some States: the increasing difficulty consumers face in finding available insurance for their homes and cars…(a) crisis being caused in part by the archaic system of insurance price controls imposed by some states…wrong-headed regulation…" Opening statement at 4/10/03 Hearing, "The Effectiveness of State Regulation: Why Some Consumers Can't Get Insurance."

"I believe that we're reaching agreement on the fundamental nature of the problem and are nearing agreement on a framework to fix it…We will be discussing a number of short-term legislative proposals to fix the state system later this year, and hope that the states can act quickly…before

Congress needs to step in and provide additional impetus. (Emphasis added) Opening statement at 5/6/03 Hearing "Increasing the Effectiveness of State Consumer Protections."

CONSUMERS DON'T CARE WHO REGULATES – IT'S THE QUALITY STUPID!

The prime issue with consumers is not who regulates insurance; it is whether insurance regulation is effective and efficient.

As a former state regulator, I have always supported state regulation of insurance, but now that I see the ease in which states panic and are willing to trade consumer protections to protect their turf, I am reevaluating my life-long support. CFA intends, over the next few months, to meet with consumer, business, labor and other interests to determine whether CFA should end its support of state regulation.

We have already determined one thing: optional federal charter legislation is harmful to consumers. The writers of these bills have readily admitted to me, to their credit, that their intent is to set up a "race to the bottom" where, in a search for regulatory market share, regulators will compete with each other to attract insurers by lowering consumer protections. Consumers can not allow this race to get started anymore than insurers would agree to a system where consumers could vote to decide which regulator would oversee the insurance industry (creating a race in the other direction).

When the NAIC began its process to head off federal oversight, consumer groups came together to write a white paper to list the consumer protections we sought. That paper, "Consumer Principles and Standards for Insurance Regulation," is attached to this statement. It presents the principles by which consumers will measure any proposal for insurance regulatory reform, be it state or federally based.

Federal Options

At the moment, federal regulatory options include the Hollings Bill, the optional federal charter idea espoused by part of the insurance industry, a simple bill that would repeal the antitrust exemption combined with oversight of the delegation of insurance regulation to the states and, perhaps, minimum standards for regulatory effectiveness and efficiency.

Hollings Bill

Only one bill before Congress considers the consumer perspective in its design, adopting many of the proposals made in our white paper. That is S. 1373 by Senator Hollings.

The bill would adopt a unitary federal regulatory system under which all interstate insurers would be regulated. Intrastate insurers would continue to be regulated by the states.

The bill's regulatory structure requires federal prior approval of prices to protect consumers, including some of the process language (such as hearing requirements when prices change significantly) so effectively used in Prop. 103. It requires annual Market Conduct exams. It creates an office of consumer protection. It enhances competition by removing the antitrust protection insurers hide behind in ratemaking. It improves consumer information and creates a system of consumer feedback.

S.1373 is a good bill and should be the baseline for any debate on the subject before this committee.

Optional Federal Charter

The bills that have been proposed would create a federal regulator that would have little, if any, authority to regulate price or product, regardless of how non-competitive the market for a particular line of insurance might be. These bills represent the wish list of insurer interests, and include minimal, if any, regulation, coupled with little improvement in consumer information or protection systems.

As stated above, the bills put forth by the industry are an amazing attempt to play off the federal government against the states. For consumers, these bills are poison and cannot be fixed. If these elements of the industry truly want to obtain "speed to market" and other advantages through a federal regulator, let them propose a federal approach that does not allow insurers to run back to the states when regulation gets tougher. We can all debate the merits of that approach.

CFA and the entire consumer community stand ready to fight optional charters with all the strength we can muster.

Amend the McCarran Act to Provide Federal Oversight and, Perhaps, Minimum Standards for Efficient and Effective Regulation

Insurers want competition to set rates, they say. How about a simple repeal of the antitrust exemption in the McCarran Act to test their desire to compete under the same rules as normal American businesses do? We will then see just how much they want competition.

Another amendment to the McCarran Act we would suggest is to do what should have been done at the beginning of the delegation of authority to the states – have the FTC and other federal agencies perform scheduled oversight of the states' regulatory performance and propose minimum standards for effective and efficient consumer protection. The Hollings bill or the provisions of Prop. 103 might be the basis for such minimum standards.

CONCLUSION

Insurers talk a good competition game, but they do not walk it. Rarely will those calling for deregulation seek to give up the antitrust exemption or increase the provision of consumer information or do the other things needed to make competition effective. Insurers seek to set up systems designed to make dual regulators fight with each other for market share by weakening consumer protections; never proposing strong regulatory floors to avoid such a result. Most insurers do not seem to want effective and efficient regulation. Rather they appear to want no regulation.

Insurers seek to continue to use Congress to pressure the states into giving up necessary consumer protections out of fear of loss of regulatory turf. To date, the pressure on the states from the Hill has come primarily from a few Members of Congress not in this body. I strongly urge you to resist engaging in such activity because it is a detriment the needs of your constituents.

I urge the Committee to continue your study of insurance regulation. The proper focus of Congress is not to encourage mindless deregulation by the states, but to encourage greater competition and economic efficiencies while strengthening, not lowering consumer protection standards.

Thank you for the opportunity to appear here today. I will be happy to answer your questions at the appropriate time.

Consumer Principles and Standards for Insurance Regulation

1. **Consumers should have access to timely and meaningful information of the costs, terms, risks and benefits of insurance policies.**

    - Meaningful disclosure prior to sale tailored for particular policies and written at the education level of average consumer sufficient to educate and enable consumers to assess particular policy and its value should be required for all insurance; should be standardized by line to facilitate comparison shopping; should include comparative prices, terms, conditions, limitations, exclusions, loss ratio expected, commissions/fees and information on seller (service and solvency); should address non-English speaking or ESL populations.
    - Insurance departments should identify, based on inquiries and market conduct exams, populations that may need directed education efforts, e.g., seniors, low-income, low education.
    - Disclosure should be made appropriate for medium in which product is sold, e.g., in person, by telephone, on-line.
    - Loss ratios should be disclosed in such a way that consumers can compare them for similar policies in the market, e.g., a scale based on insurer filings developed by insurance regulators or independent third party.
    - Non-term life insurance policies, e.g., those that build cash values, should include rate of return disclosure. This would provide consumers with a tool, analogous to the APR required in loan contracts, with which they could compare competing cash value policies. It would also help them in deciding whether to buy cash value policies.
    - Free look period with meaningful state guidelines to assess appropriateness of policy and value based on standards the state creates from data for similar policies.
    - Comparative data on insurers' complaint records, length of time to settle claims by size of claim, solvency information, and coverage ratings (e.g., policies should be ranked based on actuarial value so a consumer knows if comparing apples to apples) should be available to the public.
    - Significant changes at renewal must be clearly presented as warnings to consumers, e.g., changes in deductibles for wind loss.
    - Information on claims policy and filing process should be readily available to all consumers and included in policy information.
    - Sellers should determine and consumers should be informed of whether insurance coverage replaces or supplements already existing coverage to protect against over-insuring, e.g., life and credit.
    - Consumer Bill of Rights, tailored for each line, should accompany every policy.
    - Consumer feedback to the insurance department should be sought after every transaction (e.g., after policy sale, renewal, termination, claim denial). Insurer should give consumer notice of feedback procedure at end of transaction, e.g., form on-line or toll-free telephone number.

2. **Insurance policies should be designed to promote competition, facilitate comparison-shopping and provide meaningful and needed protection against loss.**

    - Disclosure requirements above apply here as well and should be included in design of policy and in the policy form approval process.

- Policies must be transparent and standardized so that true price competition can prevail. Components of the insurance policy must be clear to the consumer, e.g., the actual current and future cost, including commissions and penalties.
- Suitability or appropriateness rules should be in place and strictly enforced, particularly for investment/cash value policies. Companies must have clear standards for determining suitability and compliance mechanism. For example, sellers of variable life insurers are required to find that the sales that their representatives make are suitable for the buyers. Such a requirement should apply to all life insurance policies, particularly when replacement of a policy is at issue.
- "Junk" policies, including those that do not meet a minimum loss ratio, should be identified and prohibited. Low-value policies should be clearly identified and subject to a set of strictly enforced standards that ensure minimum value for consumers.
- Where policies are subject to reverse competition, special protections are needed against tie-ins, overpricing, e.g., act ion to limit credit insurance rates.

3. All consumers should have access to adequate coverage and not be subject to unfair discrimination.

- Where coverage is mandated by the state or required as part of another transaction/purchase by the private market, e.g., mortgage, regulatory intervention is appropriate to assure reasonable affordability and guarantee availability.
- Market reforms in the area of health insurance should include guaranteed issue and community rating and where needed, subsidies to assure health care is affordable for all.
- Information sufficient to allow public determination of unfair discrimination must be available. Zip code data, rating classifications and underwriting guidelines, for example, should be reported to regulatory authority for review and made public.
- Regulatory entities should conduct ongoing, aggressive market conduct reviews to assess whether unfair discrimination is present and to punish and remedy it if found, e.g., redlining reviews (analysis of market shares by census tracts or zip codes, analysis of questionable rating criteria such as credit rating), reviews of pricing methods, reviews of all forms of underwriting instructions, including oral instructions to producers.
- Insurance companies should be required to invest in communities and market and sell policies to prevent or remedy availability problems in communities.
- Clear anti-discrimination standards must be enforced so that underwriting and pricing are not unfairly discriminatory. Prohibited criteria should include race, national origin, gender, marital status, sexual preference, income, language, religion, credit history, domestic violence, and, as feasible, age and disabilities. Underwriting and rating classes should be demonstrably related to risk and backed by a public, credible statistical analysis that proves the risk-related result.

4. All consumers should reap the benefits of technological changes in the marketplace that decrease prices and promote efficiency and convenience.

- Rules should be in place to protect against redlining and other forms of unfair discrimination via certain technologies, e.g., if companies only offer better rates, etc. online.
- Regulators should take steps to certify that online sellers of insurance are genuine, licensed entities and tailor consumer protection, UTPA, etc. to the technology to ensure consumers are protected to the same degree regardless of how and where they purchase policies.
- Regulators should develop rules/principles for e-commerce (or use those developed for other financial firms if appropriate and applicable)

- In order to keep pace with changes and determine whether any specific regulatory action is needed, regulators should assess whether and to what extent technological changes are decreasing costs and what, if any, harm or benefits accrue to consumers.
- A regulatory entity, on its own or through delegation to independent third party, should become the portal through which consumers go to find acceptable sites on the web. The standards for linking to acceptable insurer sites via the entity and the records of the insurers should be public; the sites should be verified/reviewed frequently and the data from the reviews also made public.

5. Consumers should have control over whether their personal information is shared with affiliates or third parties.

- Personal financial information should not be disclosed for other than the purpose for which it is given unless the consumer provides prior written or other form of verifiable consent.
- Consumers should have access to the information held by the insurance company to make sure it is timely, accurate and complete. They should be periodically notified how they can obtain such information and how to correct errors.
- Consumers should not be denied policies or services because they refuse to share information (unless information needed to complete transaction).
- Consumers should have meaningful and timely notice of the company's privacy policy and their rights and how the company plans to use, collect and or disclose information about the consumer.
- Insurance companies should have clear set of standards for maintaining security of information and have methods to ensure compliance.
- Health information is particularly sensitive and, in addition to a strong opt-in, requires particularly tight control and use only by persons who need to see the information for the purpose for which the consumer has agreed to sharing of the data.
- Protections should not be denied to beneficiaries and claimants because a policy is purchased by a commercial entity rather than by an individual (e.g., a worker should get privacy protection under workers' compensation).

6. Consumers should have access to a meaningful redress mechanism when they suffer losses from fraud, deceptive practices or other violations; wrongdoers should be held accountable directly to consumers.

- Aggrieved consumers must have the ability to hold insurers directly accountable for losses suffered due to their actions. UTPAs should provide private cause of action.
- Alternative Dispute Resolution clauses should be permitted and enforceable in consumer insurance contracts only if the ADR process is: 1) contractually mandated with non-binding results, 2) at the option of the insured/beneficiary with binding results, or 3) at the option of the insured/beneficiary with non-binding results.
- Bad faith causes of action must be available to consumers.
- When regulators engage in settlements on behalf of consumers, there should be an external, consumer advisory committee or other mechanism to assess fairness of settlement and any redress mechanism developed should be independent, fair and neutral decision-maker.
- Private attorney general provisions should be included in insurance laws.
- There should be an independent agency that has as its mission to investigate and enforce deceptive and fraudulent practices by insurers, e.g., the reauthorization of FTC.

7. **Consumers should enjoy a regulatory structure that is accountable to the public, promotes competition, remedies market failures and abusive practices, preserves the financial soundness of the industry and protects policyholders' funds, and is responsive to the needs of consumers.**

- Insurance regulators must have clear mission statement that includes as a primary goal the protection of consumers:
  - The mission statement must declare basic fundamentals by line of insurance (such as whether the state relies on rate regulation or competition for pricing). Whichever approach is used, the statement must explain how it is accomplished. For instance, if competition is used, the state must post the review of competition (e.g., market shares, concentration by zone, etc.) to show that the market for the line is workably competitive, apply anti-trust laws, allow groups to form for the sole purpose of buying insurance, allow rebates so agents will compete, assure that price information is available from an independent source, etc. If regulation is used, the process must be described, including access to proposed rates and other proposals for the public, intervention opportunities, etc.
- Consumer bills of rights should be crafted for each line of insurance and consumers should have easily accessible information about their rights.
  - Insurance departments should support strong patient bill of rights.
- Focus on online monitoring and certification to protect against fraudulent companies.
- A department or division within regulatory body should be established for education and outreach to consumers, including providing:
  - Interactive websites to collect from and disseminate information to consumers, including information about complaints, complaint ratios and consumer rights with regard to policies and claims.
  - Access to information sources should be user friendly.
  - Counseling services to assist consumers, e.g., with health insurance purchases, claims, etc. where needed should be established.
- Consumers should have access to a national, publicly available database on complaints against companies/sellers, i.e., the NAIC database.
- To promote efficiency, centralized electronic filing and use of centralized filing data for information on rates for organizations making rate information available to consumers, e.g., help develop the information brokering business.
- Regulatory system should be subject to sunshine laws that require all regulatory actions to take place in public unless clearly warranted and specified criteria apply. Any insurer claim of trade secret status of data supplied to regulatory entity must be subject to judicial review with burden of proof on insurer.
- Strong conflict of interest, code of ethics and anti-revolving door statutes are essential to protect the public.
- Election of insurance commissioners must be accompanied by a prohibition against industry financial support in such elections.
- Adequate and enforceable standards for training and education of sellers should be in place.
- The regulatory role should in no way, directly or indirectly, be delegated to the industry or its organizations.
- The guaranty fund system should be prefunded, national fund that protects policyholders against loss due to insolvency. It is recognized that a phase-in program is essential to implement this recommendation.

- Solvency regulation/investment rules should promote a safe and sound insurance system and protect policyholder funds, e.g., rapid response to insolvency to protect against loss of assets/value.
- Laws and regulations should be up to date with and applicable to e-commerce.
- Antitrust laws should apply to the industry.
- A priority for insurance regulators should be to coordinate with other financial regulators to ensure consumer protection laws are in place and adequately enforced regardless of corporate structure or ownership of insurance entity. Insurance regulators should err on side of providing consumer protection even if regulatory jurisdiction is at issue. This should be stated mission/goal of recent changes brought about by GLB law.
    - Obtain information/complaints about insurance sellers from other agencies and include in databases.
- A national system of "Consumer Alerts" should be established by the regulators, e.g., companies directed to inform consumers of significant trends of abuse such as race-based rates or life insurance churning.
- Market conduct exams should have standards that ensure compliance with consumer protection laws and be responsive to consumer complaints; exam standards should include agent licensing, training and sales/replacement activity; companies should be held responsible for training agents and monitoring agents with ultimate review/authority with regulator. Market conduct standards should be part of an accreditation process.
- The regulatory structure must ensure accountability to the public it serves. For example, if consumers in state X have been harmed by an entity that is regulated by state Y, consumers would not be able to hold their regulators/legislators accountable to their needs and interests. To help ensure accountability, a national consumer advocate office with the ability to represent consumers before each insurance department is needed when national approaches to insurance regulation or "one-stop" approval processes are implemented.
- Insurance regulator should have standards in place to ensure mergers and acquisitions by insurance companies of other insurers or financial firms, or changes in status of insurance companies (e.g., demutualization, non-profit to for-profit), meet the needs of consumers and communities.
- Penalties for violations must be updated to ensure they serve as incentives against violating consumer protections and should be indexed to inflation.

8. Consumers should be adequately represented in the regulatory process.

- Consumers should have representation before regulatory entities that is independent, external to regulatory structure and should be empowered to represent consumers before any administrative or legislative bodies. To the extent that there is national treatment of companies or "one-stop" (OS) approval, there must be a national consumer advocate's office created to represent the consumers of all states before the national treatment state, the OS state or any other approving entity.
- Insurance departments should support public counsel or other external, independent consumer representation mechanisms before legislative, regulatory and NAIC bodies.
- Regulatory entities should have well-established structure for ongoing dialogue with and meaningful input from consumers in the state, e.g., consumer advisory committee. This is particularly true to ensure needs of certain populations in state and needs of changing technology are met.