BEFORE THE
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

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NAMIC

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TESTIFYING ON BEHALF OF THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES (NAMIC)

REMARKS TO THE U.S. HOUSE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES.

Good afternoon, Mr. Chairman, and members of the U.S. House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises**.** My name is Jim Blum. I am Chairman and President of Brotherhood Mutual Insurance Company of Fort Wayne, Indiana. I have been with Brotherhood since 1967 and have served in numerous capacities, including being named President in 1995 and Chairman of the Board in 2000.

Brotherhood Mutual dates back to 1916, when Albert Neuenschwander enlisted the help of his pastor, the Rev. Aaron Souder, in organizing a mutual aid program to provide fire and windstorm protection for members of the Defenseless Mennonite Church (now known as the Evangelical Mennonite Church). One year later, the dream became a reality when their denomination formed the Brotherhood Aid Association of the Defenseless Mennonite Conference. They chose Galatians 6:2-*"Bear ye one another's burdens and so fulfill the law of Christ"*-as the verse capturing the spirit of the new association. This verse still appears on every Brotherhood Mutual policy.

Today, Brotherhood Mutual is one of the country's leading insurers of churches and related ministries. The company writes coverages in 30 states and annually produces more than $100 million in direct written premium.

Today, I am here in my capacity as Chairman of the National Association of Mutual Insurance Companies, or NAMIC, as we are known. NAMIC is a full-service national trade association with more than 1,200 member companies that underwrite 40 percent ($123.3 billion) of the property/casualty insurance premium in the United States. NAMIC’s membership includes five of the 10 largest p/c carriers, every size regional and national p/c insurer and hundreds of farm mutual insurance companies.

Competition: The Ultimate Speed-to-Market Reform

Companies doing business across the country or in a single state need to be able to enter a new market or establish prices with a minimum of difficulty. Unfortunately, too many states continue to rely on protracted prior approval processes that obstruct, or effectively bar, the marketing of innovative products in a timely fashion.

This is a disadvantage to both insurers and consumers. Prior approval frequently takes months to secure, costing insurers valuable marketing opportunities and depriving consumers of the advantages of new and improved risk-sharing products. The length of the prior approval process also inhibits the ability of insurers to compete successfully with other, less regulated segments of the financial services industry.

A key recommendation in our regulatory efficiency report, *Accepting the Challenge: Redefining State Regulation Now,* released in April 2000, was that states consider loosening prior approval requirements. In July of last year, the NAMIC Board of Directors adopted as the association's official position an open competition model for commercial and personal lines of insurance such as the regulatory framework used in Illinois since the 1970s. Beyond state checklists, operational efficiencies and electronic filing capabilities, we believe it is the most effective public policy to achieve speed to market.

There is an emerging consensus to modernize commercial lines regulation. Markets are strong, consisting of large, well-informed corporate buyers and sellers. Smaller commercial customers are still subject to prior approval procedures in acknowledgement of a perceived lack of sophistication.

While NAMIC is pleased that some states have moved to modernize regulation for large companies, it is critical that corporate insurance buyers of all sizes be included as well. Smaller companies need the full gamut of insurance choices available to them to be competitive overall. Only when all commercial policyholders are included will the full benefits of an open market be realized.

The same argument holds true for personal lines modernization. In prior approval states, prices are controlled by insurance regulators, in theory, to keep insurance affordable and available to consumers. But, as I will discuss shortly, in states such as South Carolina and New Jersey, government-established prices have not reflected the potential cost of losses, thereby increasing the financial vulnerability of insurers and the choices available to the public.

The consequences to consumers of these public policies have been almost entirely negative. Residual markets increase as insurers reduce voluntary market sales, there are fewer new insurer-entrants to the market, services to policyholders are reduced, incentives for policyholders to control losses decline and companies affect an outright withdrawal from a market. The end result is that policies designed to serve consumers have precisely the opposite impact. Experience has shown competition to be the most effective regulator of insurance rates.

Illinois discontinued prior approval requirements 30 years ago and their rates are consistently below other states with similar demographics. Studies show that there is more competition among homeowners and automobile insurers in Illinois than in any other state despite the fact that Illinois is not the largest state in the nation. Perhaps the most telling statistic of all is that the number of drivers in the residual auto market is lower in Chicago than any urban area located in rate approval states.

Illinois legislators are evidently pleased with this public policy. No bill to re-establish prior approval of rates has ever received a majority vote in either chamber of the Illinois legislature. As Dr. Phillip O'Connor, former Illinois Director of Insurance has written in his report, *Modernizing Insurance Regulation: Tacking to the Winds of Change,*

> "The reality is that over three decades in Illinois, no serious and sustainable constituency has developed favoring any form or rate regulation legislation, let alone a return to prior approval. Illinois' elected policy makers have found little reason to consider a return to regulation."

South Carolina has also experienced notable success with modernization of rating laws as well. During the first half of the 1990s, an average of 59 insurers did business in South Carolina while other southeastern states averaged 197 insurers. After the South Carolina legislature modernized auto insurance rate making practices in 1997, South Carolinians benefited from the choices provided by almost twice as many insurers and by a dramatic drop in the size of the residual market.

To refute what I have said in favor of competition, some will refer you to what has been written about the California's celebrated passage in 1988 of Proposition 103, mandating a 20 percent rollback in automobile premiums and a prior approval system for rates after two generations of competitive pricing.

Auto insurance rates <u>have</u> fallen and complaint volume at the California Department of Insurance is low. But simply slashing prices one-fifth without employing methods to lower the cost of inevitable losses could only result in insurer instability as company losses outpaced their ability to recoup expenses.

Insurance premiums are driven by expected loss costs; and California, with its massive population and multiple urban areas, will always be a high potential loss state. Fortunately, California's Supreme Court acted two months before Prop 103 was passed to overrule adverse prior decisions that had led to dramatic increases in auto claim-related lawsuits during the 1980s.

In addition, new laws were enacted to mandate seat belt use and reduce fraud by permitting its prosecution as a felony. Also, voters approved a bar on uninsured pain and suffering damages, commonly known as No Pay/No Play.

Therefore, it was this series of explicit public policy choices-- by lawmakers, voters and the courts--not the institution of prior approval that has caused prices to go down in California. It has even been suggested that prices in California could be lower still were it not for a restrictive rate law that makes adjustments uncertain, keeping them unnaturally high.

For the other side of the coin, I encourage you to review the regulatory environment in New Jersey, where consumers pay the highest premiums for auto insurance in the nation. Like California, New Jersey is densely populated with large urban concentrations, two critical factors in an insurer's cost calculations.

But there are also many regulatory obstacles that drive up costs in New Jersey such as strict prior approval, mandatory coverage requirements, an excess profits law, territorial rate caps and barriers to exit.

In 1998, New Jersey enacted the Automobile Insurance Cost Reduction Act (AICRA) that required mandatory 15 percent rate decreases and reforms aimed at reducing costs to insurers, although none of these reforms were projected to reduce costs by 15 percent as well. Even so, many of the cost reduction measures have yet to be implemented. Coupled with the “take all comers” law, insurers with high costs may well have insufficient revenues from which to pay claims.

Pricing relief is generally not available in New Jersey. Prior approval is so strict that the rate approval process takes a year. Over the last two years, 29 of 32 rate filings were rejected; and the three approvals were for only a portion of the requested adjustment.

Six of the ten largest auto insurers do not do business in New Jersey. Only about 60 companies in all do write auto insurance in the state. Within the last two weeks, State Farm, the state’s largest writer with over 800,000 automobile insureds, announced that the regulatory climate in New Jersey was forcing them to withdraw from the state.

Some time over the next few years, one out of every five auto insurance buyers in New Jersey will be placed with a new carrier. That will mean confusion for some. For many, it will mean higher rates immediately. With one fifth of the market up for grabs and one giant provider no longer in the picture, there will be even less incentive to lower rates, among those few companies left in the market. Under this scenario, some consumers may simply decide not to carry auto insurance at all. That will mean more uninsured motorists and higher costs for drivers involved in accidents with them.

This afternoon you will hear compelling economic evidence that property-casualty markets are structurally competitive and that there is no apparent benefit to companies or consumers to perpetuating a system where rates must be approved prior to their implementation. NAMIC endorses those findings.

Requiring insurance regulators to spend their time doing what the market does more efficiently hurts insurers and consumers. Prior approval can be burdensome to regulators. Insurance departments are inundated with hundreds of filings each week, all requiring the attention of an over-worked staff otherwise unable to help monitor the marketplace. Reform would free regulators to undertake serious efforts to keep markets open, competitive and safe.

Opening insurance markets to more competition from across the country will not be realized overnight. Much will have to be done before comprehensive modernization can be enacted. By necessity, speed to market modernization requires a new approach to protecting consumers.

If state legislators need to balance the granting of market competition for insurers with a guarantee for consumer protection, reforming the market conduct examination program along the lines suggested by NAMIC in our *"Market Conduct Regulation for a Competitive Environment"* public policy paper would achieve that public policy balance. The NAIC has already begun a review process in this regard.

NAMIC is enthusiastic about the review of personal lines regulation now underway by both the NAIC and NCOIL. This is consistent with our position for open competition

We are developing an initiative in conjunction with our trade colleagues and national state legislative organizations to implement rate reform language in state legislatures beginning next year.

NAMIC supports model legislation, to be adopted by each state, that would have the following characteristics:

1. The existence of a statewide, competitive market for all lines of insurance would be presumed as a matter of law. The burden of proving the contrary would rest with the party making the allegation that a market lacks competition.
2. In a competitive market, personal line filings would be made within 30 days of their effective date and could only be disapproved if they are inadequate or unfairly discriminatory.
3. No filing would be required for commercial lines in a competitive market.
4. In a noncompetitive market, filings must be made 30 days prior to their effective date and may only be disapproved if they are excessive, inadequate or unfairly discriminatory.
5. The determination that a market is noncompetitive may only be made after an administrative hearing and the burden of proof is on the party making the allegation that the market is noncompetitive.
6. A ruling that a market is noncompetitive must specifically state all bases supporting that conclusion and actions the commissioner will take to re-establish competition. The ruling is valid for one year and may only be renewed after hearing.
7. All rulings must be issued in the form of findings of fact and conclusions of law and may be challenged in a court of competent jurisdiction. Renewal rulings must follow the same format and must also set out the actions the commissioner took, why those actions failed and what further steps will be taken to correct the problem.
8. The commissioner has an affirmative duty to monitor competition in the markets and to protect competitive markets.

Enactment of statutes like this by the states would firmly establish competition rather than prior approval as the preferred public policy governing insurance in the United States. With adequate due process protections, it would provide insurers with the predictability that products would be allowed to come into the market more quickly, affording consumers more choices at lower prices.

The Nature of the Problem Facing American Insurers

Driving us to undertake this initiative is the frustrating and inconsistent regulatory procedures and requirements present in the current state system. A drafter's note in a proposed NAIC Property and Casualty Model Rating Law suggests that average approval processes last from 15 to 90 days. Anecdotal information suggests that this note is overly optimistic. One academic study has concluded that in states with the strictest regulatory approval process, entry to the market can take almost 90 percent longer than it does in states with fewer approval requirements. These delays limit product options and reduce competition, which ultimately hurts consumers.

Compliance alone is costly. The NAIC has found that companies spend $1 billion annually to keep up with commercial lines regulatory requirements. State governments spend another $40 to $55 million each year to process prior approval filings.

There are widespread industry complaints about the use of so-called "desk drawer" or "non-statutory" regulatory requirements. In other words, regulatory decisions based on "rules" with no basis in law.

A recent NAIC survey found that one state identified 33 filing requirements for commercial lines polices, eight of which were "unpublished." The NAIC recognizes this problem and has targeted it for reform in its Improvements to State-Based Systems Report.

Accountability for Speed to Market Reform

Holding the National Association of Insurance Commissioners (NAIC) solely accountable for enacting insurance regulatory reforms is not a realistic expectation.

Given the non-binding nature of the NAIC, I would submit that the more powerful players in any struggle for state regulatory modernization are the men and women who write the laws in the country's 50 state capitals and the District of Columbia. Or, to borrow an old saying, "The NAIC proposes but the legislature disposes."

The real potential for state reform can be measured by the will of state legislatures to act. Individual regulators clearly have a role to play in their states to raise the profile of and enlist support for these important market reform issues. In the final analysis, however, state legislative action should be the focal point of accountability for speed to market reform.

For state regulatory modernization to occur, a trusting partnership must be nurtured among regulators, legislators and the insurance industry to bring about comprehensive, fundamental reform in public policy. This is not a new concept.

As a result of several well-publicized insurance-company insolvencies in the late 1980s and the early 1990s—and concerns expressed by Congress that states were not adequately performing as regulators—the NAIC resolved to improve the state solvency surveillance regime.

NAIC created the accreditation process. It identified several key model bills that were seen as strengthening the financial oversight of companies. Perhaps foremost in this effort was the NAIC's Codification of Statutory Accounting Principles, which was directed at making uniform the states' patchwork of insurance accounting. Codification required legislatures, by act in every state, to delegate authority to prescribe insurance accounting procedures to the NAIC.

Working closely with state legislative organizations like the National Conference of Insurance Legislators (NCOIL), the NAIC was able to coordinate enactment of the necessary legislation for accreditation in nearly every state across the country. A renewal component was built into the accreditation and most states continue today to remain accredited by the process that the NAIC created.

A more recent example of a trusting partnership is the uniform producer licensing requirements mandated by the Gramm-Leach-Bliley Act (GLBA).

In its advisory role to the states, the NAIC brought together regulators and industry to craft a model act to fulfill the GLBA requirements for a more uniform producer licensing process across the country. During the past two legislative sessions, 35 of the 51 bills introduced in the states have been enacted and that number is expected to possibly reach 40 by the end of the year.

These two examples underscore the type of action that we all seek to achieve speed to market reform.

The NAMIC Board of Directors has committed fully the resources of the association to achieving a uniform state regulatory regime that reflects the realties of today's marketplace and is rapidly adjustable to the marketplace of tomorrow.

Two of our public policy principles relate specifically to speed to market concerns. They are:

- Market Pricing – States should eliminate the approval process for pricing insurance products. The insurance company must have the responsibility and opportunity to price its product based upon its own market research and strategic plan.

- Speed to Market – Combined with market pricing, the regulator must eliminate burdensome and unproductive approval processes that impede delivery of quality products to consumers.

There should be no doubt, however, that the power to make these changes resides in the 50 state capitals and the District of Columbia.

Getting There From Here

NAMIC takes the interest of Congress in the future of insurance regulation seriously. We understand that your affirmation of the McCarran-Ferguson Act in the Gramm-Leach-Bliley Act of 1999 was undertaken with the intention that state insurance regulation would become as efficient as possible to help serve consumers.

These hearings are helpful to the reform process and we welcome them. They keep all parties engaged in the discussion of how competition can be enhanced in all segments of the financial services industry. No insurance company and no state will be unaffected by the outcome of this debate.

The NAIC did well to develop “Statement of Intent” initiative in March 2000 and for focusing its attention on what NAMIC believes is the most pressing market reform issue, speed-to-market.

We are also encouraged by the NAIC’s list of rate and form filing recommendations that call for development of checklist standards, a move to a 30-day approval process and consideration of competitive rating standards with little regulatory oversight.

But these are preliminary, critical steps of an important, but nonetheless, voluntary organization.

Ultimately, the accountability for reforming insurance regulation is with state legislatures and they are up to the task.

This is a time of unparalleled unity of purpose among industry and policymakers on the subject of creating a competitive regulatory environment. Given the opportunity to advocate this message strongly, clearly and persuasively, we have a fighting chance to succeed.

Thank you.

BIOGRAPHY OF MR. JAMES A. BLUM

James A. Blum, CPCU, Chairman and President
Brotherhood Mutual Insurance Company
6400 Brotherhood Way, P.O. Box 2227
Fort Wayne, Indiana 46801-2227

Born:	April 7, 1942 in Berne, Indiana
Education:	Graduated from Berne-French High School, 1960 Graduated from Butler University, 1965, BS Business Administration Chartered Property & Casualty Underwriter (CPCU) designation, 1980

Career:

Fruehauf Trailer company, Fort Wayne, Indiana	
Cost Accountant	1965-1967
Brotherhood Mutual Insurance Company	
Statistician	1967-1972
Assistant Treasurer	1972-1982
Treasurer	1982-1983
Vice President – Operations and Treasurer	1983-1990
Senior Vice President – Operations and Treasurer	1990-1994
President and CEO	1995-present
Chairman and President	2000

Other Affiliations:

National Association of Mutual Insurance Companies (NAMIC) – executive committee and chairman of the board
National Association of Mutual Insurance Companies (NAMIC) Merit Society
Taylor University – board of trustees
Fort Wayne Rescue Mission – board member
Fort Wayne Rotary Club – member
Northern Indiana Chapter of CPCU – board member
Goodwill Industries of NE Indiana - board member
First Missionary Church, Fort Wayne – active member and on Missions Committee

Personal:	Married to Jocelyn; daughters, Jennifer Nahrstadt and Joan Doran; three grandchildren