Consumer Federation of America

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BEFORE THE SUBCOMMITTEE ON
CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTERPRISES
OF THE FINANCIAL SERVICES COMMITTEE
U.S. HOUSE OF REPRESENTATIVES

JUNE 21, 2001

Let me begin by dispelling a few myths:

- Consumers do *NOT* want speed to market for bad insurance products. These are complex legal documents that consumers cannot readily understand. Consumers need the assurance of review by some regulatory entity. There is no evidence that consumers are clamoring for insurance products with less scrutiny from regulators whose job it is to protect them. Is the pressure for speed to market coming from the victims of life insurance company churning or vanishing premiums? Or from the victims of race-based premiums? Or from the consumers who were sold auto policies without a warning that the parts that would be used to repair their car would be substandard?
- The industry likes to direct policymaker attention to rate deregulation – calling any form of rate regulation "inefficient" or "state-based rates." But they actually seek much more. They want to deregulate policy forms and risk classification systems.
- Deregulation does *NOT* assure more competition or beneficial competition. For instance, deregulated policy forms can make price competition impossible. Simple deregulation in insurance, given the industry's antitrust exemption embodied in the McCarren-Ferguson Act and many state law impediments to competition, will not increase competition.

[1] Mr. Hunter served as Federal Insurance Administrator under Presidents Ford and Carter and as Texas Insurance Commissioner. His CV is attached to this testimony as Exhibit A. Neither he, nor CFA, have received any grants or contracts since October 1, 1999 from the federal government related to the subject of this testimony.

- Competition is ***NOT*** always beneficial for consumers. Some forms of competition are harmful to consumers (e.g., reverse competition in credit insurance where the competition is for the bank or car dealer and the competition drives rates up to allow bigger kickback commissions; fine-print competition where insurers hollow out coverage with clever policy language to offer low rates with high profit and selection competition such as redlining of the inner cities).
- Just enacting deregulation without making competition effective will not produce the best results for consumers. Prior approval regulation, if intelligently coupled with pro-competitive laws, work best. The state in the nation with the best practices for auto insurance regulation is California, where Proposition 103 enacted by the people of the State in 1988 both assured competition and strengthened regulation. Since 1988, California rates have fallen 12% while the typical state rates rose almost 40%, and the profits in California for insurers have been the highest of any state.
- Consumers do ***NOT*** care who regulates insurance, the federal government or the states. Consumers only care that the consumer protections afforded be excellent.
- Consumers do ***NOT*** favor a system where the regulated get to choose who regulates them. That is a sure prescription for a race to the bottom for insurance regulation.
- Consumers do care that the insurers have been blatantly using the threat of congressional interest, including this hearing, to bludgeon the NAIC and the states into submission for their inappropriate ideas to cut away vital consumer protections. Congress should make it clear to the states that, while unnecessary fat in the regulatory process should be eliminated, the states should not cut away any necessary consumer protections.
- Consumers want functional regulation to mean more effective consumer protection and not simply be a euphemism for regulatory arbitrage. Federal and state banking and insurance regulators must work together to ensure that insurers do not create a competition among regulators for the least consumer protection.
- The so-called "academic" studies of regulation should be viewed with skepticism as these studies and their authors are either funded directly or indirectly by the insurance industry. While the industry has unlimited resources – typically gained from premiums paid by consumers – to buy the research that fits their deregulation agenda, consumers must rely upon the volunteer efforts of advocates.

Background

The financial services marketplace is experiencing rapid change. The Gramm-Leach-Bliley Act ("GLB") hastened the mergers and diversification already happening among financial firms. New product designs, faster ways of accessing money from more sources and e-commerce all hold great potential for consumers. But they also expose consumers to risk of loss, especially when consumers lack information about policies and their value.

Unfortunately, consumer laws have not kept pace with the changes, especially in the area of insurance. Dramatic improvements in insurance regulation are needed to promote beneficial competition and protect insurance consumers.

In response to the passage of the GLB law and federal encroachment on state-based insurance regulation, the states and the NAIC have embarked on a timely and much-needed "reinvention" of insurance regulation process.

Consumers have supported much of the change NAIC proposes to obtain greater speed to market for the insurers. Indeed, I served as one of the consumer representatives on the Speed to Market Committees of the NAIC over the last year and a half. Consumers identified many ways that states could shorten the regulatory process. We supported a 30-day limit on final action, for example and an end to unknown rules for regulatory action, known as "desk-drawer" rules. What we do not support is "mindless" deregulation that some of the insurers advocate.

We define "mindless deregulation", as taking the position that just stopping regulation will make competition happen. There is simply no evidence of this. In fact, given the industry's antitrust exemption nationally and in most states, simple deregulation will not succeed. Further, most states have retail price maintenance laws on the books so that agents don't compete with each other within a single company (just like refrigerator dealers did not compete prior to the striking down of wholesale level control over the retail prices). In some states groups cannot form to buy insurance. Anti-competitive practices, such as joint use of future cost projections in pricing, are commonplace.

As the reinvention process proceeds, it is useful to assess the rationale for and record of insurance regulation and determine how and what changes can be made to help ensure the needs of all stakeholders, including consumers and the industry, are met.

<u>The Rationale and Record of Insurance Regulation</u>

We suggest that the rationale behind insurance regulation is to promote beneficial competition and prevent destructive or harmful competition in various areas.

<u>Insolvency:</u> One of the reasons for regulation is to prevent competition that routinely causes insurers to go out of business and leave consumers unable to collect on claims. Insolvency regulation has historically been a primary focus of insurance regulation. After several insolvencies in the 1980s, state regulators and the NAIC enacted risk-based capital standards and implemented the accreditation program to help prevent and identify future insolvencies. The 1990s experienced far fewer insolvencies and state regulation appears to be doing a good job, though the strong securities markets have helped shore up companies' retained earnings, called "surplus." Some changes were made in the guaranty fund system but there are still some significant gaps in the protection for consumers.

<u>Unfair and Deceptive Policies and Practices</u>: Insurance policies, unlike other consumer products or services, are complex legal contracts that promise to make certain payments under certain conditions and at some point in the future. Whereas a consumer can easily research the price, quality and features of a television, the consumer has very limited ability to do so on insurance policies. Because of the complicated legal nature of insurance policies, the consumer relies on the representations of the seller/agent to a far greater extent than for other products. Regulation exists to prevent competition that causes unfair and deceptive policies, sales and claims practices. An example of competition that is adverse to consumers in this area is what we

term "fine-print" competition, where insurers compete for profits by deceptive policy provisions that reduce coverage.

Unfortunately, states have not fared as well in controlling unfair and deceptive policies and practices. Rather than acting as the instigator of enforcement actions, states more often have *reacted* after lawsuits or news stories brought bad practices to light. For example, the common perception among regulators that "fly-by-night" companies were the ones to fear was shattered by widespread allegations of misleading and deceptive practices by household names such as MetLife, John Hancock, and Prudential. Though it is true that state regulators eventually took action, e.g., coordinated massive settlements, the allegations were first raised in private litigation.

One of the problems insurance departments face is a lack of resources for market conduct regulation. Consumer Federation of America's (CFA) recent survey indicates it would take five to seven years for states to complete market conduct exams on all of their domestic companies, over 50 years for all companies. Only 15 of the jurisdictions meet the standard of devoting 10% of premium taxes to regulation. This means that states making up 75% of the country's population have inadequate resources. It is not surprising that many of the industry's bad practices fall through the cracks. 15 states perform no market conduct exams at all.

So things go through this porous sieve, e.g.:

- Though banned in rating over three decades ago, life insurance companies have used race in rating older policies since that time.
- States now are investigating alleged unfair claims practices (the use of bogus medical reasons to deny claims for injuries) of State Farm after the television news show *Dateline* aired a story about several lawsuits against the insurer.

While the industry and some regulators criticize it, litigation has been a better market conduct enforcement tool in many instances than state regulation. Mindless deregulation will surely be a bonanza to the trial bar as it is certain that more bad products/practices will be in the market if deregulation occurs.

<u>Insurance Availability</u>: Some insurance is mandated by law or required for other activities (e.g., mortgage). In a normally competitive market, insurers compete on the basis of selection of consumers. Selection competition leads to availability problems and redlining.[2] Regulation exists to limit destructive selection competition.

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[2] The industry's reliance on selection competition can have negative impacts on consumers. Insurance is a risk spreading mechanism. Insurance aggregates consumers' premiums into a common fund from which claims are paid. Insurance is a contractual social arrangement, subject to regulation by the states.

The fact of the common fund in which wealth is shifted from those without losses (claims) to those with losses (claims) is why the contribution of insurance companies to the Gross National Product of the United States is measured as premiums less losses for the property/casualty lines of insurance. The U.S. government recognizes that the losses are paid from a common fund and thus are a shift in dollars from consumers without claims to those with claims, not a "product" of the insurance companies.

Competition among insurers should be focused where it has positive effects, e.g., creating efficiencies, lowering overhead. But rather than competing on the basis of the expense and profit components of rates, the industry has relied more on selection competition, which merely pushes claims from insurer to insurer or back on the person or the state. States have failed to control against the worst ravages of selection competition (e.g. redlining).

Some of the vices of selection competition that need to be addressed include zip code or other territorial selection; the potential for genetic profile selection; income (or more precisely credit report) selection; selection

Lawsuits brought by fair housing groups and the Department of Housing and Urban Development (HUD) reveal availability and unfair discrimination exist but demonstrate a lack of oversight and attention by many of the states. NAIC had ample opportunity after its own studies indicated a problem to move in the direction of protecting consumers but retreated when the industry threatened to cut off database funding, a primary source of NAIC funds.

The industry has been adamantly opposed to disclosure of zip code data and underwriting guidelines. Such disclosure would promote competition and benefit consumers but states, for the most part, have refused to require such disclosure, apparently agreeing with the industry that such information is “trade secret” despite the absence of legal support for such position. In addition, though insurance companies want to compete with banks that come under Community Reinvestment Act (“CRA”) requirements of data disclosure and addressing needs of underserved communities, they refuse to acknowledge a similar responsibility to communities.

Reverse Competition: In certain lines of insurance, insurers market their policies to a third party, e.g., creditors or auto dealers, who, in turn, sell the insurance to consumers on behalf of the insurer for commission and other compensation, often not disclosed to the consumer. Absent regulation, reverse competition leads to higher, not lower prices for consumers because the higher the price the higher the compensation for third party sellers.

Every few years, consumer groups issue reports on the millions of dollars overcharged for consumer credit insurance. Despite the overwhelming evidence that insurers do not meet targeted loss ratios in most states, most states have not acted to protect consumers by lowering rates.

Low value life insurance and industrial life insurance, markets characterized by overpriced and inappropriately sold policies and a lack of competition, demonstrate the need for standards that ensure value and honest disclosure. Insurers rely on consumers’ lack of sophistication to sell these overpriced policies. With some exceptions, states have not enacted standards that ensure value or provide timely, accurate disclosure. Consumers continue to pay far too much for very little coverage.

Information for Consumers: True competition can only exist when purchasers are fully aware of the costs and benefits of the products and services they purchase. Because of the nature of the policies and pricing, consumers have had relatively little information about the quality and comparative cost of insurance policies. Regulation is needed to ensure consumers have access to information necessary to make informed insurance purchase decisions and to compare prices. Some states have, according to studies by CFA, done fairly well at getting good information out to consumers but all too often the marketplace and insurance regulators have failed to ensure adequate disclosure. Their failure affects the pocketbooks of consumers, who cannot compare adequately on the basis of price.

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based on employment. Targeted marketing based solely on information such as income, habits, preferences, etc. leaves consumers in need of insurance out, perhaps unfairly. The data being collected by the web and otherwise can be used to profile for selection.

For decades, consumer advocates pressed for more meaningful disclosure for life insurance, including rate of return disclosure. Then the widespread misleading and abusive practices by insurance companies and agents of the mid-90s prompted state regulators, through the NAIC, to develop model illustration laws and other laws to address the problems. Regulators voiced strong concern and promised tough action to correct the abuses. While early drafts held promise and included some cost-comparison requirements, the industry successfully lobbied against the pro-consumer provisions. The disclosure model that NAIC adopted is inadequate for consumers to understand the structure and actual costs of policies or to comparison-shop.

While information and outreach efforts of states have improved, states and the NAIC have a long way to go. Few, if any, states provide information to consumers about their rights vis-a-vis their insurance policies. The NAIC's website does not focus on consumers, although there is a move that has just begun to make it more so. CFA's studies on consumer outreach reveal gaps in information. For example: 22 states have no auto insurance price guide; 34 states have no homeowners insurance price guide; and only 6 states have comprehensive health price guides. No state has a life insurance price guide. In a majority of the states, consumers do not have access to complaint ratio information for auto, homeowners, health or life insurance.

States have done somewhat better in getting information up on web pages. However, many offer no price information or complaint ratio information. Further, the states have not set up electronic rate filings as a way to assist private price vendors get quote service data updates automatically, despite repeated requests from consumers for such a system. The NAIC has a national complaint database that consumers have asked be released for years but it still languishes in the computers, not helping consumers determine which companies offer good service. Fortunately, at the NAIC meeting just concluded in New Orleans, the NAIC voted to make this data public by the end of the year.

Are the reasons for insurance regulation still valid in the wake of the GLB law? We believe that the reasons for regulation are as relevant, or in some instances even more relevant, today than five or ten years ago:

- Advances in technology allow insurers to pursue selection competition to an extent unimaginable ten years ago and give insurers access to detailed data about customers.
- Advances in technology allow insurers to reach consumers in ways not possible ten years ago.
- Insurance is being used as a tool to fund a greater share of a person's future income, e.g., annuities.
- Competition from other financial firms for the same customers can serve as an incentive for misleading and deceptive practices and market segmentation, leaving some consumers without access to the best policies and rates.
- Combination of insurer and lender functions under one corporation will lead to even greater incentives to sell inappropriate add-on insurance – or to inappropriately fund insurance policies through high cost loans – making some products subject to abuse.

As consumers are faced with these changes, it is more important than ever that insurance laws be updated and the consumer protection bar raised.

Is the NAIC Moving in the Right Direction for Consumers?

We strongly agree that dramatic improvements in insurance regulation are needed. Although the NAIC declares that the primary purpose of regulation is to protect insurance consumers, it is unfortunately clear that the NAIC approach is leading toward mindless deregulation (without the application of antitrust laws or informed consumers) of the kind sought by the insurance industry.

We can tell you with certainty that consumers, who have been the victims of vanishing premiums, churning, race-based pricing, creaming, and consumer credit insurance policies that pay pennies in claims per dollar in premium, are NOT clamoring for such policies to be brought to market with even less regulatory oversight than in the past. We think smarter, more efficient regulation benefits both consumers and insurers and leads to more beneficial competition.

We question the entire premise behind less front-end regulation coupled with more back-end (market conduct) regulation. The track record of market conduct regulation has been extremely poor. As noted above, insurance regulators rarely are the first to identify major problems in the marketplace.

From an efficiency and consumer protection perspective, it makes no sense to lessen efforts to prevent the introduction of unfair and inappropriate policies in the marketplace. It takes far less effort to prevent an inappropriate insurance policy or market practice from being introduced than to examine the practice, stop a company from doing it and providing proper restitution to consumers after the fact. The deregulation pushed by the industry will surely be a class-action attorney's dream come true.

The unique nature of insurance policies and insurance companies requires more extensive front-end regulation than other consumer commodities. And while insurance markets can be structured to promote beneficial price competition, deregulation does not lead to, let alone guarantee, such beneficial price competition.

We think front-end regulation should be designed to prevent market conduct problems from occurring instead of inviting those problems to occur. We think front-end regulation should be designed to promote beneficial competition – price competition, loss mitigation efforts – and to deter destructive competition – selection competition, unfair sales and claims settlement practice. Simply stated, strong, smart, efficient and consistent front-end regulation is critical for meaningful consumer protection and absolutely necessary to any meaningful modernization of insurance regulation.

The following principles and standards for insurance regulation will serve as the measure for consumers of NAIC's (or a federal bill's) commitment to consumer protection in the reinvention process. The consumer representatives presented the principles and standards to the NAIC in September of 2000.

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., action 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. Unfair trade practices acts 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.

<u>Speed to Market</u> –

You requested my analysis of the NAIC activities in achieving Speed to Market. I would say that the NAIC has moved faster on this set of priorities than I have experienced in my over 40 years of observing their activities. Nothing motivates like fear of loss of turf. And, they have done much to undermine necessary consumer protections in the process.

The two (CARFRA and Improvements to State Based Systems Subgroup – ISBSS) Speed to Market subgroup's activities last year were biased towards insurers and against consumer protections. Both of the subcommittees' actions virtually ignored the consumer representatives' white paper recommendations.

For example, the CARFRA subcommittee's proposal ignored the need for a dedicated consumer advocate to participate in the CARFRA review process, the need for consumer representation on the CARFRA Board, and the need for dedicated funding outside of insurer control. The life insurers complained about public access to information during the CARFRA review process, so public access during the review period was totally eliminated. This decision, of course, eliminates even the modest opportunity for consumer input into the CARFRA review contained in the draft proposal, reducing rights consumers currently enjoy in several states.

The property casualty insurers complained that CARFRA would "centralize" insurance regulation and demanded that the CARFRA launch be limited to life products. The NAIC agreed, even though the same need exists for property casualty products as for life products to improve the quality and consistency of regulatory reviews across states. The abandonment of property casualty products – during a test period! – means that consumers have no hope of strengthening state insurance regulation for these products through the CARFRA process.

The bias towards insurers was further demonstrated when Commissioner Fitzgerald, co-chair of the subcommittee, explained the abandonment of property casualty products from CARFRA by saying that the "customers" did not want it. While it was refreshing to hear an insurance regulator speak honestly about whom regulators serve, consumers are also customers and the NAIC ignored its pledge, in the <u>Statement of Intent</u> that it would seek to protect consumers "proactively and aggressively." We are customers who want the quality of property casualty filings review improved across the states, not eliminated in a rush to keep insurers from seeking a federal option.

At the same time that CARFRA dropped review of property/casualty filings, the Improvements to State Based Systems (ISBSS) subcommittee adopted commercial lines deregulation unaccompanied by improvements in other regulatory tools.

The ISBSS gave insurers commercial lines deregulation in place by mid-2001 while paying lip service (through mere promises of possible future charges and studies perhaps starting at the end of 2001) to consumer information, market monitoring information and consumer representation in the regulatory process. They punted on data disclosure for the public to monitor redlining. The subgroup ignored the problem of selection competition. While urging regulators to find a way to implement commercial lines deregulation even if the state regulatory framework called for prior approval or file and use, the subgroup simply advised regulators to follow state law and technical capabilities when it came to consumer access to information.

We spent a lot of time providing detailed comments to the Speed to Market working group. They accepted many of our proposals for cutting unnecessary regulations and putting a 30 day time limit on review of filings, but they rejected all of our requests to couple commercial lines deregulation with enhanced consumer information. We asked for a point-by-point explanation of why the working group rejected all our recommendations (in executive session). We were never told despite repeated requests for such information.

Consumers agreed with the bulk of the regulatory efficiency improvements suggested by the industry and even suggested many ourselves.

COMMERCIAL LINES

Consumers do not mind certain deregulatory efforts. For example, we agree that large commercial accounts do not need regulation of any sort, either for the policy forms or rates.

As to small businesses, we believe that they are no more sophisticated than ordinary consumers are. A driver of a one-truck delivery business does not have risk managers and/or lawyers to call on to analyze a policy. Prior approval form regulation is required to assure this small business that the complex legal contract being tendered is what it seems to be.

Even as to rates, prior approval regulation is needed. The rating systems include territories, classifications, underwriting rules and other very complex systems that have significant public policy implications. (See Personal Lines immediately below).

PERSONAL LINES

The NAIC has begun in 2001 a review of personal lines regulation. That led consumer groups to undertake a major review of regulatory regimes throughout the nation to determine which system works best for consumers.

Policy forms are complex legal documents that need to be regulated so that consumers are not misled into buying what appears to be a low-cost policy only to find, when a claim is filed, that the cost is low because the fine print has removed almost all of the coverage.

One of the most pressing issues in insurance today is the increasing use of non-risk related factors by insurers to determine a consumers premium. With increased access to consumers personal information and cheap computing power, insurers are developing ever more refined risk classification systems that reward segments of their market– typically white and affluent – and penalize others – typically poor and minority. Insurers' use of consumes credit history for underwriting and rating is the prime example. For some insurers, a consumer's credit history carries more weight in determining the premium than driving record. The determinations about how we group consumers for purposes of assigning premium is a profound public policy decision. Left to unfettered market forces, health insurers would only insurer healthy people. Greater – certainly not lesser – regulatory oversight of risk classifications is necessary.

Another recent class being tested is the use of global positioning satellites (GPS) in insured autos. This presents obvious questions of privacy and fairness. The insurer using this system in the test, Progressive, says people who drive at night will pay more. Is it fair to make a person who must work the swing shift pay more because he drives during a time when more drinkers drive? If I stop at my health club but the GPS sees me parked across the street near Mike's Bar and Grill, should I pay more?

And what's next? I guarantee you that life and health insurers will use the genome to rate risk. Is that good? Is it bad? Should that decision be unregulated by some public entity?

The standards we used to measure the excellence of regulation were based upon our principles and standards set forth above. They include that the law:

- Make regulation easily understood by, responsive to, accountable to and inspire confidence from the public and regulated entities.
- Promote beneficial competition towards the end of fair profits for regulated entities and fair treatment of consumers.
- Make public policy the primary determinant of risk classification schemes.
- Provide for public involvement in the regulatory process, including institutionalized consumer participation in review of forms, manuals and rates.
- Provide the regulator, regulated entities and the public with the tools to identify market problems and harmful competition such as redlining.
- Prevent harmful products from coming to market, deter regulated entities from unfair and harmful practices, stop harmful practices from continuing and provide restitution to consumers injured by harmful and unfair practices of regulated entities.
- Promote loss prevention and loss mitigation as the most important way for insurers to manage exposure.

By these measures, one state, California, stands out as the state with the statutory provisions that most meet these standards. The people of California put most of these provisions into place by the 1998 enactment of Proposition 103. We particularly like the Proposition's powerful combination of increased competition through repeal of the state antitrust exemption, repeal of the anti-rebate law, repeal of the anti-group law and so on, coupled with strong regulatory back up. This combination works to give the consumers of California the best system in the nation.

We then tested California's performance since Prop 103 became effective to determine if these best provisions really produced the expected positive results for consumers and for the insurers as well. Among our remarkable findings were:

- Auto insurance rates went down in California by 12.0% while nationally, in the typical state, rates were rising by almost 40%.
- California has enjoyed the lowest rate change of any state in the nation since the adoption of Proposition 103.
- The savings enjoyed by Californians total nearly $30 billion.
- Rate rollbacks totaling $1.3 billion were paid to consumers.
- Loss costs were controlled by the strong incentives for driver safety built into the initiative. "Clean" drivers received a 20% discount. They also gained the right to buy insurance from the company of their choice.
- Insurer expenses were reduced by the system of disallowing excess expenses and fines, coupled with increased competitive pressure.
- In 1989 8.4% of the insureds in California were in the Assigned Risk Plan. In 1999, the percentage had fallen to 0.3%. This represents an astounding drop in the Assigned Risk Plan of 96%.
- From 1989 to 1997, the uninsured motorist population declined 38%.
- There was entry and exit consistent with a competitive industry. The number of insurer groups competing in the state increased by 17%.
- Proposition 103 produced excellent profits for insurers; the highest in the nation.
- Proposition 103 encouraged a national movement by insurers to fight fraud, push for safety and cut costs.

CFA has presented this study to the NAIC and has forwarded it to each of the 50 state insurance commissioners. It is available on the CFA web page at www.consumerfed.org.

As you think about Proposition 103's achievements, don't forget to compare it to other major regulatory changes in recent years. In California alone there have been three major changes. First, Prop 103 moved insurance from deregulation to regulation and real competition. Two other regulatory changes in California went from regulation to deregulation. Electricity, about which I will not comment, and workers compensation insurance. It is now in crisis with 8 of the 12 top writers now in solvency trouble.

Recommendations to Congress

1. We ask Congress not to allow the industry to continue to use you as a threat to gain the mindless deregulatory changes they propose.
2. We request that you carefully consider all proposals that come before you to see that the principles and standards we have set out for consumer protection are part of any Congressional action you take.
3. Please reject any system that gives the regulated an option to go back and forth between regulators, playing them off against each other to lower protections. Any optional system must contain minimum standards for both regulatory regimes, high standards based upon the above principles.

4. We recommend that you look to California for a model personal lines regulatory system that works best for consumers and gives excellent profits to consumers as well.

Exhibit A

J. ROBERT HUNTER
2202 North 24th Street
Arlington, VA 22207

Summary

Consulting actuary with nearly 40 years of experience with the insurance industry, primarily engaged in analysis of major public policy issues relating to regulatory and consumer issues.

Academic Education

B.Sc. in Physics, Clarkson University, Potsdam, N.Y., 1958.

Professional Qualifications and Professional Association Activities

Casualty Actuarial Society. Fellow (by examination).

American Academy of Actuaries. Member

Experience and Employment

Present

Self-employed consulting actuary.

Also serve as *pro-bono* Director of Insurance for the Consumer Federation of America (CFA). (See "*Pro Bono* Activities," below.)

Employment in the Private Insurance Industry.

1959-1960. **Atlantic Mutual Insurance Companies.** Underwriter, working on several lines of insurance, including commercial property/casualty insurance.

1960-1966. **National Bureau of Casualty Underwriters (NBCU)** (a forerunner organization of the Insurance Services Office (ISO)). I ran their state rate-filing unit, and later became an automobile rate making supervisor in the actuarial department. Duties included: analysis of claims experience for rate making; presentation of the rate requests to the appropriate Bureau committees for action; and presentation of the adopted rate levels to state officials, sometimes in hearings.

1966-1970. **Mutual Insurance Rating Bureau (MIRB) and the Mutual Insurance Advisory Association (MIAA).** I was an Associate Actuary, engaged in activities similar to those in which I was engaged at NBCU, but for all lines of property/casualty insurance (including liability insurance). As an officer of MIRB and MIAA, I dealt directly with the General Manager and was responsible for much of the research undertaken at these organizations.

MIRB/MIAA were forerunner organizations to the Automobile Insurance Plans Service Office ("AIPSO"), the organization charged with servicing and helping run, for the insurance industry, the residual market mechanisms (usually assigned risk plans) for automobile insurance in the U.S.

1970-1980. **Federal Insurance Administration, U. S. Department of Housing and Urban Development**, under HUD Secretary George Romney.

I served in a number of positions, including Chief Actuary, Deputy Federal Insurance Administrator, Acting Federal Insurance Administrator, and Federal Insurance Administrator.

During my ten-year stint in federal insurance regulation (1970-1980), I was involved with insurance-related public policy issues of the highest order. I testified before Congress on many occasions on the programs of the Federal Insurance Administration, as well as on insurance issues generally (such as the purported medical malpractice insurance "crisis" of the mid nineteen-seventies, the costing of health insurance, no-fault auto insurance proposals, and many other issues). I also served on federal inter-agency task forces dealing with products liability insurance, medical malpractice insurance, risk retention group formation, workers' compensation insurance, and other issues.

I was responsible for actuarial and public policy advice to HUD regarding statutory programs (*e.g.* flood insurance, the Riot Reinsurance/FAIR Plan, and Urban Crime Insurance) and many other matters as requested by the White House and other federal agencies. Some examples:

- Administered the FIA's Riot Reinsurance/FAIR Plan program. ("FAIR Plans" are the residual market for fire (homeowners and business properties) insurance. These were usually Joint Underwriting types of organizations.) In my work administering this program, we made many examinations of FAIR Plans, including reviewing claims practices. I participated in writing a book-length overall analysis of the public interest issues involved in residual market insurance (Fair Plan and automobile assigned risk plan) entitled *Full Insurance Availability* (HUD 1974).

- Administered the FIA's flood insurance program, which included both homeowner and business insurance. I monitored claims-paying approaches of the insurance companies that serviced the flood insurance program.

- Wrote the actuarial regulations for President Nixon's temporary 1972 wage- and price-freezing directives as well as for other phases of that program, and helped run some insurance rate cases for the Price Commission.

- Worked with the U.S. Department of Transportation on its landmark no-fault automobile insurance study.

- Worked with the U.S. Department of Labor on workers' compensation insurance matters.

- Worked with the U.S. Federal Trade Commission on life insurance matters.

- Worked with the White House on national health insurance proposals.

I received the HUD Secretary's Award for Excellence by Secretary Carla Hills for the work I performed from 1971-1977.

State Insurance Regulation

1993-94 **Insurance Commissioner of the State of Texas**, appointed by Governor Ann Richards. In charge of the day-to-day operations of the Texas Department of Insurance (TDI). Made all executive decisions on insurance policy matters that arose during my tenure, including rate making, statistical collection, loss prevention, solvency monitoring, residual market issues, enforcement, examination, claims practices, complaint resolution, consumer information dissemination and myriad other matters attendant to running a major government agency such as TDI.

I also undertook a major reorganization of TDI, cutting the staff from 1,100 to about 900 and greatly decentralizing the authority to the remaining staff. TDI became a much more effective and efficient organization during my brief tenure.

As Texas Insurance Commissioner, I was a member of the National Association of Insurance Commissioners (NAIC). Served on the Executive Committee of the NAIC and as Vice-Chair of the Western Zone of the NAIC and member of the Life Insurance Committee. Served on several advisory groups to the NAIC, including the Advisory Committee to the Task Force on Profitability and Investment Income, the Market Conduct Advisory Committee, the Nuclear Insurance Advisory Committee and as co-chair of the Technical Resource Group to the Statistical Task Force.

(Since leaving the insurance regulation field I have served as a "funded" consumer representative to the NAIC (i.e. NAIC paid travel expenses to facilitate my attendance at their meetings).)

Private Actuarial and Public Policy Consulting

1980-1993 Conducted my own actuarial and insurance public policy consulting practice, voluntarily limiting my clients to *government agencies* and *consumers of insurance* to avoid even the appearance of any conflict of interest *vis-à-vis* my work on consumer matters. (Clients are named below under "Public Policy Research and Testimony".)

1994-to date Actuarial and insurance public policy consulting practice; resumed *pro-bono* activities as Director of Insurance for the Consumer Federation of America.

Extensive consulting work on a variety of insurance issues for state agencies, including:

Ratemaking and profitability matters (early 1980s) and disciplinary actions related to market conduct abuses for the Florida Department of Insurance.

Pricing and public policy issues related to tort reform measures for the New York, Maine and California legislatures.

Medical malpractice insurance for the Governor of Puerto Rico

Workers' compensation insurance rate making for the Attorney General of Oklahoma, the Attorney General of Virginia, the Public Advocate of Maine, the Public Advocate of Florida and the Governor of Puerto Rico.

Private passenger automobile insurance as a member of the Governor's Task Force in the State of New Jersey.

Private passenger automobile insurance *rate making* for the Public Advocate of New Jersey, the Public Advocate of South Carolina, the Attorney General of Connecticut, the Attorney General of Massachusetts, the Attorney General of Virginia, the Attorney General of California, the Office of Public Insurance Counsel in Texas and the Departments of Insurance in California, Georgia, New Jersey, North Carolina, and Texas.

Insurance implications of hurricanes as a member of the consulting team for the Academic Task Force in the State of Florida following Hurricane Andrew in 1992.

Antitrust and reinsurance as a member of the Governor's Subcommittee on Antitrust and Reinsurance in Virginia.

Public Policy Research and Testimony

Testified as an actuarial expert on behalf of clients (such as those listed below); on behalf of the private insurance industry when I was employed there during the nineteen-sixties; on behalf of consumer organizations such as NICO, CFA, Consumer's Union (publisher of *Consumer Reports*), Common Cause, and others; on behalf of the States of California, Florida, Massachusetts, New Jersey, New York, North Carolina, Oklahoma, South Carolina and others; and on behalf of the federal government from the 1980s to the early 1990s.

Testified or performed research for federal agencies, including:

U.S. Department of Labor (on Workers' Compensation rate making)

U.S. Department of Health and Human Services (on Medical Malpractice)

U.S. Environmental Protection Agency (on insurance aspects of hazardous waste)

U.S. General Accounting Office (on federal tax policy and rate issues)

The U.S. Congress's Office of Technology Assessment on several issues.

Testified frequently before committees of both the U.S. House of Representatives and the U.S. Senate, as Federal Insurance Administrator, as President of NICO, as Texas Insurance Commissioner, and as Director of Insurance at CFA.

Testified before every state legislature in one forum or another.

News Media Writing and Interviews

Articles published in *The New York Times*, *The Washington Post*, *The Los Angeles Times*, the *Dallas Morning News*, *USA Today*, *The Wall Street Journal*, and other leading newspapers.

Quoted extensively in the insurance industry press and the general media.

Interviews on numerous TV programs, including “Larry King Live,” “60 Minutes,” “This Week With David Brinkley,” “The Today Show,” “Good Morning America,” “CBS Morning News,” “CBS Evening News,” “NBC Evening News,” “Fox News,” “Donahue,” and “Oprah Winfrey.”

Frequent appearances on radio shows—both news programs (*e.g.* National Public Radio’s “All Things Considered”) and talk shows (*e.g.* Larry King).

Publications

Published Articles and Papers

2001 J. Robert Hunter, *Why not the Best? The Most Effective Auto Insurance Regulation in the Nation,* (Consumer Federation of America, June 2001). Analyses the state regulatory regimes for auto insurance and concludes that California’s system, adopted by a vote of the people of the state in 1988, constitutes the finest regulatory system in the country.

1998 J. Robert Hunter, *America’s Disastrous Disaster “System”* (Consumer Federation of America, 1998). Analyzes critically the current approach to handling disasters in this nation and proposes an alternative system that would end taxpayer subsidy of anticipated levels of damage, move the cost of high risk to those who live in high risk areas, and minimize death and damage due to unwise construction practices.

1995 J. Robert Hunter, *Product Liability Insurance Experience, 1984-1993* (1995)

1995 J. Robert Hunter, *Medical Malpractice Insurance Experience*, *1984-1993* (1995)

1995 J. Robert Hunter, *Auto Insurance—Progress Through Reform But More To Be Done* (1995)

1994 J. Robert Hunter, “Insuring Against Natural Disaster,” *Journal of Insurance Regulation* (1994).

1993 J. Robert Hunter, “Rate Suppression, A Critique”, *Journal of Insurance Regulation* (1993).

1985 J. Robert Hunter and Professor Raymond Hill (Princeton University), *Workers’ Compensation Insurance Rate making: Regulation of Profit Margins and Investment Income*. (Written under contract for the U.S. Department of Labor.)

1983 J. Robert Hunter, “Study of Feasibility of Risk Retention Groups for Hazardous Waste Facilities,” in the *Journal of the Chartered Property Casualty Underwriters’ Society*. Addressed the possible use of risk retention groups to ease the tight market for environmental coverage. (Written under contract for the Environmental Protection Agency.)

1983 J. Robert Hunter and Dr. John W. Wilson, *Investment Income and Profitability in Property/Casualty Insurance Rate Making* (1983). Paper was instrumental in convincing the NAIC to adopt "total return rate making procedures" as the preferred rate regulatory model.

Reports

2000 J. Robert Hunter, *Study of State Insurance Departments, Part III: Internet Web Page Grades*. (CFA) This report gave the internet site of the Florida Department of Insurance a grade of "A," which resulted in a DOI press release publicizing the Department's good grade: "Insurance Department Gets 'A' For Consumer-Friendly Web Site, " viewable at http://www.doi.state.fl.us/consumers/alerts/press/2000/pr032400.htm.

2000 J. Robert Hunter, *1988, 1993, and 1998 Changes in State Insurance Department Resources*. (CFA)

1999 *Consumer Information Available From State Insurance Departments*. (CFA)

1999 *Insurance Department Grades for Consumer Complaint Information*. (CFA)

1986 J. Robert Hunter, *Insurance in California: Profitability, Competition and Equity in Selling and Pricing Private Passenger Automobile Insurance and the Crisis in Day Care and Municipal Liability Insurance*. Commissioned by the California legislature. The principal document used by the drafters of Proposition 103 as a blueprint for casualty insurance reform in California.

1984 Series of reports on the interrelationship of gender and miles driven in setting auto insurance rates.

1981 J. Robert Hunter, *Gas Prices and Auto Rates: Insurance Implications of the Dynamic Changes in America's Driving Habits*.

5. J. Robert Hunter, *Taking the Bite Out of Insurance: Investment Income in Rate Making*. Led to a major NAIC study of this issue.

Pro Bono Activities

1980-93 I created an insurance consumer organization, the National Insurance Consumer Organization, which I served *pro-bono*. NICO was the first national organization dedicated to looking at all kinds of insurance (except pensions) from a consumer perspective. It undertook research and advocacy on behalf of consumers, and became the leading voice for consumers on insurance issues.

NICO published information advising consumers how to buy insurance of all types, fielded complaints from consumers, developed a computerized service to help consumers understand cash value life insurance products and otherwise dealt on a daily basis with the needs and concerns of insurance consumers, including their understanding of insurance contracts.

1995 to date	Serve *pro-bono* as Director of Insurance for the Consumer Federation of America (CFA), 1424 16th Street, NW, Suite 604, Washington, DC 20036.
	CFA is a federation of some 240 consumer advocacy groups with a combined membership of more than 50 million Americans.