TESTIMONY OF ALLIANCE OF AMERICAN INSURERS &
NATIONAL ASSOCIATION OF INDEPENDENT INSURERS

BEFORE
U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON
CAPITAL MARKETS, INSURANCE and GOVERNMENT SPONSORED ENTERPRISES

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I am pleased to present the following statement on behalf of the Alliance of American Insurers (AAI) and the National Association of Independent Insurers (NAII). Together we represent over 1000 property/casualty insurance companies doing business across the United States. In terms of property/casualty insurance marketshare, collectively our members write 45 percent of the property/casualty market. We want to commend the members of the Subcommittee for holding this important hearing. During the next few minutes I will provide the Alliance and NAII's perspective on the critical issue of regulatory modernization and speed-to-market.

SPEED-TO-MARKET ISSUE

Support for the ability for insurers to compete in a competitive marketplace has been the hallmark of our respective organizations from their inception. We are hearing from our members, however, unprecedented levels of concern regarding the regulation of rates and forms in many states and how it is hurting competition. The reality is that insurance markets have evolved at a much faster pace than insurance regulation. There is significant diversity across the states on how property and casualty rates and forms are regulated. Also, different lines of business have varying levels of regulatory oversight in a given state. Personal and commercial lines rate and form regulatory laws in many jurisdictions have roots in the 1940s and are now grossly outdated. Many states still

require prior approval of all changes in automobile insurance rates and forms. These "prior approval" requirements only serve to drain insurance department resources that could be better directed toward other activities such as solvency and market conduct. They add to the underlying costs of insurance, and stifle innovation.

Regulatory approaches taken by the states fall within the following spectrum of options:

- Prior Approval – Insurers must receive approval in advance before any changes in pricing or policy forms can be made.
- Flex Rating – Under this approach, companies can increase or decrease rates within a certain range without obtaining prior approval.
- File and Use – In these states, changes in rates and/or forms must be filed with the Insurance Department, which generally will have 30 days to review the filings before the given changes can be used.
- Use and File – Under this approach, product and pricing changes can be used immediately as long as they are filed with the Insurance Department. Most states taking this approach still allow the Insurance Department to check and measure these changes against applicable statutory and regulatory standards.
- Open Competition – In these states, either an informational filing or no filing is

required. (Illinois has successfully used this approach for decades for all lines of business, and several states use variations of the approach for larger commercial risks.)

It can be difficult to categorize a state due to differences in how individual lines of business are regulated. Generally speaking only about 15 states use a competitive approach in their laws governing personal lines rates. Restrictive laws and regulations are not the only barriers to bringing insurance products to market. Barriers also can take the form of problematic insurance department practices, creating a culture that limits innovation.

ASSOCIATION SURVEYS

Both of our organizations have conducted surveys of our members regarding speed-to-market in the states. Members were asked to identify the best and worst rate and/or form filing practices for both personal and commercial lines. We did indeed receive some positive feedback regarding certain states. Positive comments included timely review, fewer forms to complete, fewer layers in the process and clear instructions.

We also found confirmation of the frustration that our members feel regarding impediments to approval of rate and/or form filings in other states. Many states received at least one vote in terms of displaying a poor rate and/or form filing process characteristic. Respondents to our surveys cited the following as the most common examples of barriers to speed-to-market:

- Slow review, approval and acknowledgement of filings;
- Inadequate, inexperienced and/or non-supportive staff;
- Too many and too complicated forms;
- Burdensome requirements, rigid rules, multi-layered processes;
- Unwritten standards ("desk drawer" rules);
- Confusing or unclear instructions.

Beyond individual practices, our members commented that in some states the department culture or mindset toward excessive regulation impedes competition.

The number one problem identified by the members in the surveys was slow approval or even acknowledgement of filings. On a national commercial product rollout, generally, an insurer can expect that approximately twenty-six (26) states or jurisdictions will approve a commercial filing in less than 60 days; some may take less than thirty (30) days. Approximately, nineteen (19) states will approve the product within 90 days. The

remaining six (6) states may take up to a year for approval.

Some of these hurdles can be at least partly ameliorated by implementing operational reforms at the insurance department level. Clearly, however, in many states there also is a need for a public policy change that would provide a more streamlined competitive environment, with regulator attention being more focused on solvency and market conduct issues rather than micro-management of individual insurer rates and forms.

In constructive fashion we are following up with insurance departments across the country to discuss the barriers to bringing new products to consumers. The purpose is to encourage each state regulator to implement as many operational reforms as possible in the short term. We also pledge our support and assistance toward working together with each regulator to win enactment of public policy changes in the legislature.

EXPERIENCE IN MORE COMPETITIVE STATES – BENEFITS FOR CONSUMERS

The survey results from our members reflect growing frustration over the fact that property casualty insurance in particular remains one of the most heavily regulated markets in the United States. Some states including but not limited to Illinois have more

competitive oriented regulatory systems and the benefits for consumers as well as insurers are clear. There is a growing body of academic studies regarding prior approval versus more competitive regulatory rate laws and the benefits for consumers in states with competitive systems. Examples of some of the latest academic evidence indicates:

1. "There is little or no evidence that prior approval on average has a material effect on average rates. … Prior approval regulation is, however, reliably associated with lower availability of coverage. It is positively and significantly related to residual marketshares, even when states with reinsurance facilities or related residual market mechanisms and the largest residual marketshares are excluded from the comparison. Prior approval regulation also is reliably associated with greater volatility in loss ratios and expenditure growth rates after controlling for the influence of a number of other variables that could affect volatility." (*From An Econometric Analysis of Insurance Rate Regulation*, Scott Harrington)

2. "The Illinois experience suggests that rate regulation for automobile insurance is unnecessary. Illinois has functioned without a rating law since 1971. Auto insurance is widely available from a large number of competitors. Rate changes are frequent, modest and appear to follow claim experience. Loss ratios and the size of the uninsured and residual market are in line with that in states that have competitive rating laws. Thirty years of experience suggests that the automobile insurance market functions without regulation." (*Insurance Price Deregulation: The Illinois Experience*, by Steven D'Arcy)

3. "From the mid-seventies through 1998, South Carolina intensively regulated auto insurance. Rate levels and rate structures were restricted, insurers underwriting discretion was limited and large cross-subsidies were channeled through its residual market. Contrary to political expectations, but consistent with economic theory, these regulatory

> measures worsened market conditions. … South Carolina's prior approval system was replaced by flex rating and restrictions on risk-based pricing and underwriting were substantially eased. The Reinsurance Facility and its large subsidies are being phased out and replaced temporarily by a JUA and ultimately by an assigned risk plan that will be required to charge adequate rates. … With most of the reforms becoming effective in 1999, it is too soon to determine their ultimate outcome, but the early prognosis is positive. The number of insurers writing auto insurance has doubled with the implementation of the reforms. Many insurers have implemented more refined risk classification and pricing structures, as well as alternative policy options for consumers. It also appears that overall rate levels have continued to fall, possibly reflecting declining claims costs, as well as the easing of restrictions of risk-based pricing. Most importantly, the Facility is depopulating rapidly." (*Auto Insurance Reform: Salvation in South Carolina,* by Martin F. Grace et al)

The success of competitive rating is far from limited to Illinois. Other states such as Wisconsin have had more competitive systems for years and enjoyed the benefits of competition. More recently the benefits of competition have become clear through the experience under the reform of the South Carolina automobile insurance rating laws. The more competitive approach used in these and other states may not be fully appreciated because they have been quietly working.

Also, some states have taken specific positive action regarding reform of form filing requirements for certain risks. These include Arizona, Colorado, Michigan, and Minnesota.

Recently a consumer group issued a report extolling the alleged virtue of the prior approval system in California enacted as part of Proposition 103. We suggest that you not be misled because the real reason for the decline in rates in California was dramatic decrease in loss costs stemming from stricter enforcement of seatbelt laws, stronger drunk driving penalties, and the Supreme Court's decision eliminating third-party bad faith lawsuits. After Prop 103 was passed, bodily injury costs in California peaked in 1991 (according to *Trends in Auto Injury Claims* by the Insurance Research Council.) Academic experts including former Illinois Insurance Director Phil O'Connor have noted that consumers could have benefited even more from these reductions in underlying costs but for the prior approval system.

The clear vast majority of academic as well as empirical evidence supports competition and the benefits it can have for consumers, and the downsides of prior approval for consumers. As you can see, however, despite the existence of more competitive systems in some states there is clearly a need for multifaceted reform in many others in order to facilitate speed-to-market.

THE SOLUTION; PART ONE:

PUBLIC POLICY CHANGES – BALANCED COMPETITION FOR CONSUMERS

While our organizations support competition, we do not call for elimination of regulation. We suggest states adopt laws that rely upon competition among insurers to determine insurance rates but also provide for regulatory intervention and consumer protection if a market is considered not to be competitive. Specific features of this approach which have to be tailored on a state-by-state basis, include:

1. Competitive rating law (i.e. no filing for large commercial, use-and-file for personal lines.)
2. There would still be a prohibition on rates that are excessive inadequate or unfairly discriminatory.
3. A regulator could not consider a rate excessive in a competitive market.
4. If a market is found not competitive, insurers would then have to receive prior approval of rate changes.
5. Advisory organizations may collect basic data but are prohibited from recommending rates or engaging in anti-competitive behavior.
6. All insurers and advisory organizations must maintain adequate records that can be

examined for compliance with the Act.

7. We have also proposed a specific requirement that consumers be given access by Insurance Departments to helpful information on pricing and coverages.

On the issue of forms, our recommended model includes the insurer self–certification process which has been highly successful in Colorado. Insurers submit a certification to the Colorado Insurance Department, which has authority to check the forms at any given time as well as during market conduct exams.

This approach strikes a reasonable balance by providing a competitive system, but with appropriate consumer safeguards such as additional authority for the insurance regulator upon a finding that a particular insurance market is not competitive. This approach also has to be refined to fit the nuances of each state.

THE SOLUTION; PART TWO:

OPERATIONAL EFFICIENCIES

We wish to commend Ohio Insurance Director Covington and the activities of the NAIC Improvements To State-Based Systems Subgroup. That group in 2000 produced a number of practical and operational suggestions that, if adopted immediately by individual insurance departments, would to a certain extent help speed the process of

product approval in the states. Those suggestions include elimination of desk-drawer rules, use of clear checklists regarding what must be in a filing, and specific timeframes for action by insurance departments on proposed rate and form changes.

In our discussions with states, we have seen that many states are beginning to move toward more efficient regulatory practices. Unfortunately, we must share one concern. While some changes are being made in some states on process and procedure, the need to deal with mindset and regulatory culture remains in several others. Changing this culture and mindset will take time.

It is up to individual state insurance departments to effectuate operational efficiencies. We hope that regulators will also work with state public policymakers, as we are, to ultimately effectuate the public policy changes needed to assure that consumers are not denied the benefits of more competitive environment.

EARLY SIGNS IN THE STATE LEGISLATURES

Though the number of states is small, in various jurisdictions across the country state legislatures have considered or are considering during these current 2001 legislative sessions the potential for enactment of more open competition laws. For example, in Connecticut and Rhode Island legislators considered but ultimately did not enact flex-

rating. The same result occurred in Nevada, which also considered a flex-rating approach. Alaska and Missouri enacted more competitive provisions on commercial lines. The Louisiana Legislature is still in session, and that Legislature is considering watershed reform that would largely eliminate the current rating commission approach and implement a file-and-use alternative. Also, it is good to note that since 1997, 22 states have adopted provisions eliminating filing requirements for certain commercial risks. Recall as well that Illinois and other states have had positive reforms in place for some time, and South Carolina is the best recent (1999) example of the benefits of implementing a more competitive system.

LEGISLATIVE GROUPS

In addition to our activities surrounding the surveys, plus our activities in individual states, both of our organizations have worked closely with national legislative groups such as National Conference of Insurance Legislators (NCOIL), the American Legislative Exchange Council (ALEC) and the National Conference of State Legislatures (NCSL) in order to highlight the importance of improving regulation in terms of modernization and efficiency. We participated in NCOIL's extensive hearing in early March regarding personal lines modernization. That organization is considering a

competitive model law similar to one already adopted by ALEC. More recently, we participated in a panel discussion before the NCSL, to highlight the importance of this issue and to provide our thoughts on state-based solutions.

Clearly, part of the solution can be found in the operational efficiencies recommended by the NAIC. There also must be public policy changes for personal as well as commercial lines that take more competitive approach.

CONCLUSION

The Alliance and NAII commend this Subcommittee for holding a hearing on this vitally important topic. The persistence of prior approval rate regulation in some lines and states has imposed barriers to speed-to-market, with very negative effects for consumers. We need continued and accelerated reform in states on two fronts: implementation by insurance departments of the operational efficiencies and adoption by state legislatures of more competitive laws.

There is clear academic and empirical evidence in support of the value of modernization for consumers, especially in terms of marketplace stability, lower residual market populations, enhanced availability, and more accurate cost-based pricing. The experience of our members in key states supports these very same conclusions.

Property/casualty insurance remains one of the most regulated markets in the United States. Regulation of property casualty insurance products in particular must be modernized to embrace the benefits of competition, albeit with balanced consumer protections. The model approach outlined above strikes the appropriate balance and we urge states to support it.

We see some signs of progress through:

1) Activities at NAIC on the modernization issue;
2) Adoption by some state insurance departments of the operational efficiencies recommended by NAIC;
3) Studies conducted by and/or model laws produced by state legislative organizations, such as NCOIL, NCSL, and ALEC;
4) Action in a limited number of state legislatures thus far.

Clearly, however, there is need for action on both the operational efficiencies and public policy changes in more states. The time has come for unprecedented and truly meaningful cooperative activity among the NAIC itself, individual regulators, and state legislators as well as industry and consumer representatives in order to accomplish the important goal of modernization, consistent with the vision of Gramm-Leach-Bliley.

BIOGRAPHY

ROBERT L. ZEMAN

Robert L. Zeman serves as vice president and assistant general counsel for the National Association of Independent Insurers (NAII). Mr. Zeman's responsibilities at the NAII include supervision of all state legislative and regulatory affairs as well as involvement in corporate, litigation and policy development matters. He attained both a B.A. in political science (Cum Laude, 1982) and a Juris Doctor degree (1985) from Loyola University of Chicago.

Mr. Zeman's areas of expertise include tort liability, automobile insurance and constitutional law and he has published several articles on these subjects. He serves as liaison between NAII and a number of legislative and regulatory groups including the National Association of Insurance Commissioners, the American Legislative Exchange Council, and the National Conference of Insurance Legislators. Mr. Zeman is the current chairman for NCOIL's Industry Education Council.

He has served as chairman of the American Bar Association's Public Regulation of Insurance Law Committee, and as a member of that organization's special standing Committee on Public Relations. He is also a member of the American Corporate Counsel Association, the International Association of Defense Counsel, and the American Society of Association Executives.

U.S. House of Representatives
Committee on Financial Services

Disclosure Requirement
Required by Clause 2(g) of Rule XI of the Rules of the House and the Rules of the Committee on Financial Services

1. Name:	2. Organization or organizations you are representing:
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	Yes	No
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 1999 related to the subject on which you have been invited to testify?		X
5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 1999 related to the subject on which you have been invited to testify?		X

6. If you answered "yes" to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether you or the organization you represent was the recipient. You may list additional grants or contracts on additional sheets.

Signature: Robert L Z

Please attach a copy of this form to your written testimony.