Consumer Federation of America
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STATEMENT OF
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BEFORE THE
FEDERAL INSURANCE OFFICE

REGARDING
CONSUMER PROTECTION NEEDS IN INSURANCE REGULATION

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Good morning. I am Bob Hunter, Director of Insurance for the Consumer Federation of America (CFA). I appreciate the opportunity to discuss with you this morning what the Federal Insurance Office (FIO) can do to improve insurance regulation for consumers. I request that you please put my written remarks in the record of this conference.

Consumers are facing far-reaching problems in the property/casualty insurance market today. Today I will touch on several concerns: (1) the unaffordability of auto insurance for many low- to moderate-income consumers, caused in part by insurers' use of rating and classifications' practices that have a disparate impact; (2) the continuing adverse impact on consumers and competition of the McCarran-Ferguson Act's antitrust exemption for insurers; (3) the use of unregulated "black boxes" by insurers to price policies and pay claims and, (4) the unjustifiably high cost of credit-related insurance caused by market failures and insurer "kickbacks" paid to lenders.

As you listen to insurance representatives talk about the need for regulatory uniformity this morning, I urge you to ask them what they really mean. Words like "modernization," excessiveness," and "outdated" are often dangerous as used by insurers, because their end-goal is often deregulation that does not adequately protect consumers. We vigorously disagree. Our research shows that strong regulation significantly improves results for consumers <u>and</u> increases competition. This does not mean that consumer organizations support regulatory inefficiency, as consumers pay for that. But any move toward regulatory uniformity for consumer protection must be at the highest levels, not a low level. In fact, we have noticed that insurer' enthusiasm for uniformity seems to disappear when the discussion involves raising standards to the level of states like California. We believe a strong case exists for consumer protections, including prior approval of classes and rates.

<u>STATE REGULATION IS INADEQUATE TO PROTECT CONSUMERS</u>

Three of these serious problems are caused by poor or no oversight by state regulators of insurance industry practices. There are four main reasons why state insurance commissioners rarely succeed in adequately protecting consumers: lack of authority, lack of will, lack of resources and lack of sufficient power to balance the overwhelming influence of the insurance industry at the state level.

In 2009, Americans spent $1,787 billion on private insurance: $655 billion to insurers that provide life and health coverage $567 billion to insurers that only provide health coverage, $457 billion to property/casualty insurers, $9 billion to fraternal insurers, $9 billion to title insurers, $82 billion to captive insurers and $9 billion to other types of insurers.[1] The average American household spent $15,599 on insurance in 2009.[2] In that year, the personal disposable income in America was $11,035 billion.[3] Insurance expenditures, therefore, represented 16.2 percent of America's disposable income. (Looking just at premiums paid directly by consumers, or on their behalf by employers as a benefit, the total in 2009 was $1.1 trillion, or $10,476 per household – 9.5 percent of disposable income) Research suggests that this percentage is even higher for low- and moderate-income Americans who, more frequently than other consumers, end up uninsured because they simply cannot afford the coverage.

However, states usually fail to meet the challenge of protecting consumers due to excessive insurer influence on insurance policy that is not counter-balanced in any way by consumers. In virtually every state, consumers have no advocates with the ability to represent their interests before insurance commissioners. National consumer advocates are significantly outspent and outnumbered and cannot possibly match the power of the industry. Couple this with the "revolving door" that exists between regulators and the industry and the imbalance becomes staggering.[4] In addition, a Harvard study of state insurance regulation in 1983[5] found that two-thirds of regulators view their role as arbiters between competing interests rather than as advocates for consumers who are essentially unrepresented in the process. It is impossible to be an fair arbiter with no organized, funded, effective and professional consumer presence to argue the contrary position -- if necessary-- to the heavily lobbied industry positions. Only a few states have attempted to empower consumers.

Even if state regulators attempted to improve their consumer protection efforts, they would likely be unsuccessful, as regulators rarely have the necessary resources to carry out their heavy workloads. In 2011, the four states that spend the most on insurance regulation (New York, California, Texas and Florida) will spend 53 percent of the total spent by all states and territories.[6] There were 129 life/health actuaries and 89 property/casualty actuaries in state regulation in 2009. This represents a little more than two life/health actuaries and one property/casualty actuaries per state. By comparison, Prudential Insurance has 287 actuaries;

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[1] *2009 Insurance Department Resources Report*, National Association of Insurance Commissioners, at 40-41 (2010).
[2] Number of households in 2009 estimated by increasing the U.S. Census Bureau's 2000 household count of 105 million households by the 9.1 percent increase in population reported by the Census Bureau from 2000 to June 30th 2009.
[3] *Personal Income and its Disposition*, Bureau of Economic Analysis (Washington D.C.), Mar. 28, 2011, *available at* http://www.bea.gov/newsreleases/national/pi/2011/pi0211.htm.
[4] *NAIC Under Fire*, Insurance Networking News, March 11, 2011.and *Issues and Needed Improvements in State Regulation of Insurance*, U.S. General Accounting Office, October 9, 1979.among others.
[5]Robert H. Miles & Arvind Bhambri, The Regulatory Executives, (Sage Publications, 1983).
[6] *2009 Insurance Department Resources Report*, National Association of Insurance Commissioners, (2010).

Travelers has 204; Aetna, 120; Allstate, 147; New York Life, 239; Liberty Mutual, 172; American International, 145, and State Farm, 111.[7] Sixteen states had no life/health actuary and 18 states had no property/casualty actuary in 2009.

Much of the state work I have reviewed over the years, such as market conduct exams and regulatory efforts on rates, has been superficial and usually deferential to the position of insurers. Market conduct exams almost never discover abuse until well after private lawsuits uncover it. These exams are usually a bean-counting exercise designed to fulfill an obligation, rather than a rigorous fact-finding process, like discovery in litigation.

AREAS OF INADEQUATE CONSUMER PROTECTION THAT ARE RIPE FOR FIO STUDY OR ACTION

Because of these flaws in state regulation, there are many serious consumer protection problems that FIO could help address. I will just touch on just four key problems that FIO could positively affect:

1. The serious, and essentially unstudied, problem faced by LMI Americans when buying insurance. CFA has undertaken a six-month study and found great problems in the auto, home and life insurance markets for the LMI. In a moment I will focus on the most serious problem LMI consumers face: affording auto insurance.

2. The antitrust exemption for insurers under the McCarran-Ferguson Act. A related issue is whether unregulated computer programs used by several insurers to underwrite, price and settle claims violate the antitrust laws. **The FIO should examine this exemption as part of the study it is required to present to Congress next year.**

3. Unregulated "black box" models used by insurers for pricing and claims. Credit scoring and catastrophe (CAT) models greatly impact price. The use of Colossus, and usual and customary models greatly impact the size of claims paid by property/ casualty insurers. Yet these models are unregulated and need careful study. It appears that companies that develop these models often compete for market share with insurers by engineering the models to justify higher rates (such as the discredited short-term CAT model developed by Risk Management Solutions) or lower claim payouts (such as with Colossus). Almost nothing has been done by the states to understand how these systems work. (The exceptions are Florida's work on CAT modeling and the Illinois market conduct study of Allstate's use of Colossus.) **The FIO should examine the impact on consumers of unregulated third-party models as part of its study.**[8]

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[7] American Academy of Actuaries, https://actuarialdirectory.org/SearchDirectory/tabid/242/Default.aspx, (last visited May 1, 2011).

[8] One of the prime adverse impacts of the use of third-party "black boxes" is the harm caused to LMI Americans. Since they are on the lower rung of income and wealth, a small problem with finances that would not harm wealthier consumers can cause credit scoring scores to deteriorate, making it more difficult for the consumer to find affordable insurance. The use of claims' systems to push payouts down may also have a more serious impact on LMI consumers as well.

4. Credit-related insurance products, such as credit, title, and forced-placed insurance and debt cancellation suffer from "reverse competition" and thus very high prices. Reverse competition occurs because the lender, not the consumer, selects the insurer and the lender looks for more compensation from the insurer, not lower costs for consumers. This drives the price of the insurance up. Because a few states have imposed effective loss ratio caps on pricing, many lenders have shifted from state insurance-regulated products to very similar debt cancellation products overseen by federal regulators. **The FIO should study the regulation of credit-related insurance to determine if this product falls between the regulatory cracks and how regulatory arbitrage between state and federal regulators can be eliminated.**

REFORM OF AUTO INSURANCE REGULATION IS CRITICAL FOR LMI CONSUMERS

CFA has undertaken a major study of the crisis in auto insurance availability and affordability for LMI consumers. The full study will be published early next year. Our initial findings are that, not only are most states failing to protect LMI auto insurance consumers, they aren't even trying. Our review of the academic literature and state agency work shockingly found that only California and a couple of other states are studying the issue.

On November 18, 2011, the *New York Times* published an article on what it termed "the near poor."[9] At the request of the newspaper, the U.S. Census Bureau analyzed data and found that 100 million Americans – one in three – were "either in poverty or in the fretful zone just above it." One of the factors that causes the poor and near poor to struggle is the cost of auto insurance.

Most poor, near-poor and even moderate-income families must buy auto coverage. First, they are required by law, and sometimes by lenders, to purchase auto insurance. All states except New Hampshire require car owners to purchase liability coverage. In fault states, this coverage pays expenses suffered by other parties in at-fault accidents. In no-fault states, it pays for the insured party's own injuries. Further, auto lenders require car owners they are financing to pay for coverage to protect the lender's security interest in the car.

LMI consumers benefit greatly from ready access to a car. Researchers agree that, for most of these families, having this access greatly increases economic opportunities related to work, education and consumption. A U.S. Department of Transportation survey showed that lower-income households take 75 percent of their trips by car and only 5 percent by public transit.

Thus, it is not surprising that, compared to spending on other financial services, LMI households spend a great deal on auto insurance; $36 billion a year, an astonishing four times what the they spend on payday loans.[10]

However, this mandated coverage is unaffordable for many low-income people since they pay an average of about $750 in annual premiums, while moderate-income car owning households have paid about $1150 in annual premiums. These premiums vary considerably

[9] "Older, Suburban and Struggling, 'Near Poor' Startle the Census," New York Times, November 18, 2011.
[10] $9 billion. Source: Stephens Inc., Payday Loan Industry Report, April 17, 2008, p. 34.

between households and are especially high in many lower-income urban communities. To cite only one example, a single male from Compton, California -- who is under 30 years of age, has been licensed for six to eight years, drives 7,600-10,000 miles per year, and has had one traffic ticket and one-at-fault accident -- will be charged between $1,628 to $2,353 for state-required liability coverage and between $5,670 and $7,511 if lender requirements are added. **These high costs help explain why about 30 percent of LMI car owners nationwide drive without any insurance coverage.**

Not only are many LMI car owners charged high premiums relative to their incomes, but these premiums often reflect disparate treatment and/or disparate impacts, such as:

- **Less access to insurance offices**. For example, in the District of Columbia, of 80 insurance offices, only three were located in the two wards with the lowest incomes, while 45 were located in the two wards with the highest incomes.

- **Higher premiums for less coverage**. Astonishingly, according to Texas insurance department data, some major insurers in that state charge lower premiums for coverage with higher limits that the wealthy buy than for minimum liability coverage the poor buy. It appears that these insurers are discriminating against purchasers of the minimum coverage, who are disproportionately LMI consumers.

- **Higher premiums because of unjustified rating factors largely beyond the control of consumers**. LMI policyholders often pay higher premiums because insurers use rating factors that disadvantage them, including: home owners pay less; those in low-income occupations or with less education pay more; consumers with previous coverage that had low bodily injury limits pay more, and those with no access to credit or a blemished credit history pay more.

- **Higher premiums because relevant risk factors that are can be easily controlled by consumers are largely ignored**. One important factor that is ignored or downplayed by insurers supposedly using “risk-based systems” in many states is the number of miles driven annually. LMI car owners drive on average only half the miles of higher-income owners but they do not fully benefit from this fact in many cases.

- **Lower claims’ offers.** To quote one plaintiff's attorney who used to work for insurers, "It's easier for insurers to pick on the sick, the weak, and the poor than someone who is big and tough." Just last week at CFA’s Financial Services Conference, a top insurance claims executive said that lower income consumers will often take the settlement they are offered because “they need the money," while more affluent policyholders are more likely to object if they are offered a claims settlement that they view as insufficient. Unscrupulous claims’ adjusters can take advantage of this tendency by trying to intimidate a lower income claimant into accepting an offer that is unfairly low.

It is difficult to avoid the conclusion that major insurers are far more interested in selling auto insurance to higher-income families and try to avoid LMI consumers where possible.

There is much that state regulators can do to better meet the need for fairly priced auto coverage that LMI households have, including:

- **Lower minimum liability coverage requirements**. State liability requirements do not directly benefit the many LMI drivers who are effectively judgment-proof. They protect only other drivers, most of whom already carry uninsured motorist coverage. Lowering liability limits would lower premiums and spur more LMI households to purchase insurance and obey the law.

- **Create special low-income programs**. The only serious program that we are aware exists in California, which offers low-cost liability coverage to LMI drivers. The premiums are relatively low because the program offers very low liability coverage only to those with a good driving record. Although taxpayers or other ratepayers do not subsidize the program, the highest rate charged to these LMI drivers is under $400. However, CFA believes that a strong case can be made for some subsidization of these types of programs.

- **Stop disparate treatment by eliminating unfair rate classifications**, including credit scoring, education, occupation, prior limits of liability purchased, homeownership and no break in coverage in recent years. Is it really justifiable to require janitors with no accidents or tickets to pay more for the same coverage than bankers? Should people who could not go college pay more than identically risky college graduates?

As more and more Americans suffer economically, it is time to do more to help LMI consumers afford to own, insure and use autos to improve their ability to work, get to school, shop and otherwise more fully engage in all aspects of 21st Century America life. Here are steps the FIO should take to draw attention to this critical situation:

- <u>FIO should collect data</u> that can identify problems with more precision and help craft solutions to those problems. FIO should collect data similar to what bank regulators are required to gather from lenders under the Home Mortgage Disclosure Act (HMDA) as the first step in identifying and correcting many current insurance abuses that affect America's LMI consumers. CFA would appreciate the opportunity to help draft the data request for this purpose.

- <u>FIO should analyze consumer impacts in the marketplace</u>, using both currently available data from the states, in addition to the HMDA-like data, to provide strong recommendations for state, or, if necessary, federal action. (It is very clear from the history of insurance regulation that federal interest in an insurance issue usually prompts states to act).

- <u>FIO should research</u> issues that adversely affect LMI auto insurance consumers today, such as the disparate and often unfair treatment of LMI consumers in the underwriting and rating of auto and other insurance products.

I will be pleased to answer any questions you have at the appropriate time.

Other key CFA documents particularly pertinent to the issues that FIO should study:

J. Robert Hunter testimony before the House Financial Services Committee's Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises of May 14, 2009.
http://www.consumerfed.org/elements/www.consumerfed.org/file/Hunter_Testimony_HFSC_5-14-09.pdf

J. Robert Hunter testimony before the Senate Judiciary Committee on Antitrust Issues in the Insurance Industry, 10/14/09.
http://www.consumerfed.org/elements/www.consumerfed.org/file/J%20%20Robert%20Hunter%20-%20Antitrust%20Senate%20McCarran%20Repeal%20Health%20Insurance%20Testimony%202009.pdf

Consumer Letter Urging CFPA Authority over Credit-Related Insurance Products, 07/29/09.
http://www.consumerfed.org/elements/www.consumerfed.org/file/CFPA_insurance_letter_7-29-09.pdf

Testimony of Travis Plunkett, Senate Banking; Regulatory Modernization: Perspectives on Insurance, 07/28/09.
http://www.consumerfed.org/elements/www.consumerfed.org/file/Plunkett_Testimony_Reg_Mod_of_Ins_7-28-09.pdf

State Automobile Insurance Regulation: A National Quality Assessment and In-Depth Review of California's Uniquely Effective Regulatory System, 04/24/08.
http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/state_auto_insurance_report.pdf

A report on why state regulation fails to adequately protect consumers is awaiting publication in a prestigious journal, target date before the end of this month. Copies of "A Failure of Oversight in Need of Rescue: Insurance Regulation," J. Robert Hunter in final edit draft form are available to FIO on request.

A Helpful Chart:

A chart of some major areas comparing current state and federal system capacities:

Item	**Federal**	**State**
Experience overseeing all aspects of insurance regulation?	No	Yes
Responsive to local needs?	No	Yes
Handle individual complaints promptly and effectively?	No	Some States
Limited impact if regulatory mistakes are made?	No	Yes
Not subject to political pressure from national insurers?	No	No
Not subject to political pressure from local insurers?	Yes	No
Efficient solvency regulation?	No	Yes
Effective guaranty in event of insolvency?	Yes	No
Adequately restricts revolving door between regulators and industry?	Maybe	No
More uniform regulatory approach?	Yes	No
Can easily respond to micro-trends impacting only a region or a state?	No	Yes
Can easily respond to macro-trends that cross state borders?	Yes	No
Has greater resources, like data processing capacity?	Yes	No
Systemic risk analysis and control	Yes	No
Web page information excellence	Maybe	Yes