
Consumer Federation of America

**STATEMENT OF**

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**BEFORE THE**

**SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS**

# "OVERSIGHT HEARING ON INSURANCE BROKERAGE PRACTICES, INCLUDING POTENTIAL CONFLICTS OF INTEREST AND THE ADEQUACY OF THE CURRENT REGULATORY FRAMEWORK"

**NOVEMBER 16, 2004**

Chairman Fitzgerald and Ranking Member Akaka, I thank you for the invitation to discuss this important issue with you today. The Consumer Federation of America applauds this subcommittee for moving so quickly to conduct an oversight hearing about the very alarming findings of New York Attorney General Elliot Spitzer's investigation into bid rigging, kickbacks and conflicts of interest in the insurance industry. **Here is the key point I would like to make today: the Spitzer investigation reveals how easily sophisticated buyers of insurance can be duped by brokers and insurers. Imagine the potential for abuse and deceit when small businesses and individual consumers try to negotiate the insurance marketplace.**

Although some have found the results of Spitzer's investigation surprising, CFA has not. These findings are, unfortunately, a reflection of the deeply rooted anti-competitive culture that exists in the insurance industry. Only a complete assessment of the federal and state regulatory failures that have helped create and foster the growth of this culture will help Congress understand how to take effective steps to change it. On the federal side, the antitrust exemption that exists in the McCarran Ferguson Act (and that is modeled by many states) has been the most potent enabler of anticompetitive practices in the insurance industry. Congress has also handcuffed the Federal Trade Commission in prosecuting and even in investigating and studying deceptive and anticompetitive practices by insurers and brokers. On the state side, insurance regulators have utterly failed to protect consumers and to properly regulate insurers and brokers in a number of key respects. Many of these regulators, for example, collaborated with insurance interests to deregulate commercial insurance transactions, which further hampered their ability to uncover and root out the type of practices uncovered by Attorney General Spitzer.

In this testimony, I recommend a number of significant steps that Congress could take to prevent these practices and to better protect consumers. However, as you start to consider federal policy solutions to these problems, I urge you to adopt the mantra, "First, do no harm." Instead of raising the consumer protection bar by requiring a minimum, uniform level of protections in all states, insurance "reform" proposals that have been offered to date in the House would further sanction anti-competitive practices in the industry, override some of the few state protections that are still meaningful, and further encourage state regulators to compete with each other to lower standards. We strongly encourage this committee to reject the House approach outright.

## Other Implications of Spitzer Investigation

Spitzer found anti-competitive schemes that harmed corporate and municipal buyers of insurance, among the most knowledgeable purchasers of all. Brokers who are supposedly only interested in getting the best deal for customers received improperly disclosed kickbacks from insurers. There was even bid-rigging complete with fake bids.

The revelations of wrongdoing are not likely to stop with commercial property-casualty insurers and brokers. The Spitzer investigation so far has centered upon brokers, who work for the customer, as opposed to agents, who represent insurers. It has also focused on the sale of commercial property/casualty insurance and not on personal lines, such as life, health, auto and

home insurance. However, because financial conflicts of interest similar to those at the center of the Spitzer investigation exist in the sales of group life and health insurance and some personal policies, similar abuses in these areas may be uncovered.

Businesses often use brokers to undertake bidding to secure "group" life and health insurance for their employees. The same bid systems and potential for abuse exist in these group sales as in the broker-secured property/casualty insurance highlighted in the Spitzer complaint. Brokers who are supposed to be representing the businesses that are buying insurance are also taking "contingent" fees from insurance companies based on the amount of insurance that is bought. This kind of conflict of interest can lead to higher prices for buyers and hurt employees. Brokers earn more from insurers if their customers pay more.

In the area of insurance that is sold individually (non-group life and health as well as auto and home insurance), most sales involve direct-to-consumer transactions, captive agents (employed by insurers) or independent agents that work for commissions and represent different companies. Compensation provided to independent agents offers the greatest potential harm for consumers. One particular type of contingency commission is especially troubling. Insurers provide agents with a kickback at the end of the year if clients file a low level of claims. If an agent's loss ratio (the percentage of claims dollars paid out in proportion to the amount of premiums paid by buyers) is better than specified levels, the agent can get more money as a year-end bonus. The lower the agent's loss ratio, the higher the bonus the agent receives. This is an obvious incentive for an agent to delay filing a legitimate claim or to improperly advise a consumer not to file it.

**How Consumers are Harmed by Contingent Fee Arrangements**

Consumers are hurt, directly and indirectly, by these practices. Indirect effects include higher taxes if a municipality's insurance has been made more expensive by these practices and higher prices if a corporation's insurance costs rise. Direct effects would include the delay or denial of a claim based on profitability contingency commissions or increased cost of group health insurance through higher premiums for that coverage. Even if the employer pays the premium, the higher cost would leave fewer dollars available for employees, for instance, in the form of salaries.

Marsh stated that its contingency commissions amounted to $845 million in 2003. Other brokers have indicated that they received at least $250 million in contingency commissions in that year. The bid-rigging costs are not included in these figures, but it is very likely that insurers, knowing that there was no competition, took advantage of the situation to increase their profits. When one also considers the impact of this practice on other lines of insurance such as group life and health and personal auto and home insurance, it is clear that we are talking about billions of dollars in overcharges. Indeed, according to 2003 data, industry-wide property/casualty contingent commissions were $4.2 billion.[1]

[1] Best's Averages and Averages, 2004 Edition, page 614.

**The Insurance Industry's Anti-competitive Culture**

To understand how these practices could flourish, one must first understand that insurance is not a fully competitive business. Attached is a fact sheet explaining why insurance is not as subject to normal competitive pressures as most other businesses. The reasons include the complexity of the product (a complicated legal document few understand), and the need to assess the financial soundness of the insurer and service quality sometimes years before a claim is filed. Insurance pricing and underwriting mechanisms are also exceedingly complex. Moreover, some consumers will stay with the same insurer, even if they know they are paying too much, for fear of having to file a claim early on with a new insurance company. Indeed, underwriting, the ability of an insurer to say "no" at the end of a long shopping effort, is an extremely unusual aspect of insurance compared to normal products.

The complexity of the insurance marketplace and the reliance of many consumers on agents or brokers as a result leaves millions vulnerable to sharp sales tactics. Many unsuitable policies are sold, such as credit insurance policies, whole life plans for children and singles who do not need the coverage, air travel life insurance, cancer insurance and other inappropriate policies.

The upshot is that many consumers pay too much for insurance. High-priced insurers often maintain significant market share, as people frequently do not shop for insurance, placing their fate in the hands of an agent or broker. Consumers we talk to have a strange combination of feelings when it comes to buying insurance: fear and boredom. Many go to a broker or agent and essentially say, "Take me, I'm yours."

For home insurance in 2003, commissions paid to agents and brokers ranged from 0 percent to over 30 percent of premium. Among the leading writers, United Services Automobile Association (USAA) had a commission of 0 percent, Farmers had a commission of 1 percent, State Farm had a commission of 13 percent and Foremost had a commission of 26 percent. Total overhead for Foremost was 35.6 percent v. 18.7 percent for Farmers. USAA had a dividend to policyholders of over 10 percent. CFA reviews of rates charged in several markets over time show that one insurer could easily charge double the price of another for coverage of the same insured. For instance, in Pennsylvania for auto insurance, full coverage rates in Berks County for Travelers are currently shown on the insurance department website as $515, while American Independent would charge $2,178 to the same insured. In Philadelphia, the rate for Progressive Halcyon is $932, but American Independent would charge $3,607. For auto insurance in Eugene, Oregon, American Family would charge a risk $281, but State Farm would price the same risk at $2,805. In Salem, Progressive Northern would charge $449 for the same risk that Mid-Century would price at $1,251. In Crawford County, Kansas for home insurance, Union Insurance would charge $781, but Allstate Indemnity would charge that risk $2,200. In Wyandotte County, Kansas, Union Insurance would ask the price of $781 for home insurance, whereas Allstate Indemnity would ask $2,805.[2] Almost every state has shopping guides. In Hawaii, clean auto risks buying liability coverage pay from as low as $397 for USAA and Tradewind Insurance Company to as high as $993 for GEICO Casualty Insurance Company.

[2] From web pages of the individual states, visited on November 3, 2004.

Unfortunately, it is impossible to assess the rate situation in Illinois, since the insurance department does not collect such data.

Abuses also occur because this is not a fully competitive industry. Insurers are not subject to federal and most state anti-trust laws. The culture of the industry that has developed over many years is one that is unfamiliar with and often hostile to vigorous competition. This is particularly true during the less competitive "hard market" phase of the underwriting cycle of the insurance industry, when insurers tend to cut back coverage and sharply raise rates. The cycle is typically a two to three year hard market followed by an eight to twelve year soft market, where prices are stable or even fall. We have just entered a new soft market after a hard period between 2000 and 2003.

This industry has grown up exempt from anti-trust enforcement and has colluded on pricing through the use of rating bureaus and advisory organizations. For decades, rating bureaus determined full rates and filed them with state regulators on behalf of many insurance companies. In the last few years, the rating organizations have not filed full rates but continue to file "loss costs." Loss costs are the part of the rate that is anticipated to be paid out in claims to victims of injury and for the costs of adjusting and/or defending such claims. The process includes taking data from the past from many insurers and jointly manipulating the data to project these costs into the future, utilizing a process known as "trending."

To get from these jointly produced loss costs to final rates, all the insurer has to do is add overhead costs and profit. It is quite a simple matter to reproduce the old rate bureau rates, since the expense data used and the profit provision of the rate bureaus is well known. Thus, at the onset of a hard market, for instance, the industry knows the approximate level of prices that the rate bureaus would have set and moves near or to that target, sharply increasing prices to non-competitive levels. Insurers have the legal right to discuss rating and they frequently signal their intent to raise rates in trade press and by other means.

For instance, "Insurance company executives lectured, scolded and even pleaded with their counterparts to hold the line on underwriting discipline and resist any temptation to prematurely soften property/casualty market prices, during an industry conference here. 'Let's not get pulled into a soft market. We are not ready for a soft market and cannot afford one…' said James Schiro, chief executive officer of Zurich Financial Services. "Let's not get in a race for marketshare,' he said, adding that 'we need several more years of profitability' … a theme emphasized again and again by CEOs speaking at the meeting.

"Mr. Schiro was hardly alone in his position. 'It's hard to understand the euphoria over the rate increases of the past couple of years, since as an industry we still have so much farther to go to get to an even marginally acceptable return-on-equity,' said Maurice Greenberg, chairman and CEO of American International Group in New York…Mr. Greenberg added that 'in a risk business like ours, the pursuit of marketshare at the expense of earnings is not a great strategy.'

"Following Mr. Greenberg's speech, William Berkley, chairman and CEO of W.R. Berkley Corp in Greenwich, CT, said during a discussion of capital strength that 'the goal of any

carrier should not just be to sell more insurance and get bigger, but to make more money on a risk-adjusted basis. That requires adequate pricing.'"[3]

"We absolutely need to hold the line on pricing and not give in to excessive competition," said Maurice Greenberg.[4]

Obviously, the Spitzer investigation has highlighted other anti-competitive practices that have occurred in the industry as well, such as contingent commissions and bid rigging. Anti-competitive state laws also abound, including laws that prohibit groups from forming to buy insurance more cheaply in some lines of insurance (so called "fictitious group" laws) and laws that prohibit agents from negotiating lower commissions with clients (so called "anti-rebate" laws).

**What are the Lessons from the Spitzer Revelations?**

A key lesson from this scandal is that state regulation has failed to protect consumers. Previous scandals involving life insurance market conduct abuses and insolvency issues had already shown the serious weaknesses in state regulation.[5] This raises the issue of what sort of federal role might be warranted.

Whatever the federal role, it should be to enhance, not diminish, consumer protection standards. In recent years, insurers have exploited the perceived need for regulatory "uniformity" to weaken the handful of state protections that are strong and to lay the groundwork for a weak, uniform national law. State consumer protections have been reduced over the last few years as the states geared up to fight federal encroachment into insurance by luring insurers to their camp. This has been particularly true for commercial risks.[6]

In the very area of the Spitzer findings, commercial property/casualty insurance, the NAIC has moved to gut its recommended consumer protections. Rate review by regulators has been weakened for all commercial policies. Larger, more sophisticated clients have been "freed up" from state regulatory oversight. This freeing up is now shown to be highly questionable as the supposedly sophisticated buyers were duped by anti-competitive industry practices.

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[3] National Underwriter, November 21, 2003, reporting on the Annual Executive Conference for the Property/Casualty Industry.

[4] BestWire, November 24, 2003.

[5] Many states have become classic victims of regulatory "capture". Revolving doors swing freely between regulators and regulated, as about 50 percent of commissioners come from the industry and 50 percent return to it. State legislative committees and the National Conference of Insurance Legislators are often stacked with members who are part-time legislators and full-time insurance agents, executives or employees. "Issues and Needed Improvements in State Regulation of the Insurance Business," General Accounting Office, PAD-79-72A, October 9, 1979. "State Legislators and Insurance Conflicts of Interest," Consumer Federation of America, 1995. "Many State Legislators Involved With National Insurance Organization Have Close Ties To Insurance Industry," Consumer Federation of America, July 9, 2003, http://www.consumerfed.org/0709insurance.html.

[6] "Examination and Oversight of the Condition and Regulation of the Insurance Industry," Testimony of J. Robert Hunter, Director of Insurance of the Consumer Federation of America, Senate Committee on Banking, Housing, and Urban Affairs, September 22, 2004.

Another lesson is that, if consumers are to be protected, financial conflicts of interest must be eliminated. If the scandals on Wall Street, in the mutual fund industry and now in the insurance industry have taught regulators anything, it is that consumers inevitably lose when financial conflicts exist. Most insurance agents and brokers are honest, but if the compensation system provides an incentive for bad behavior, it will inevitably occur. To weed out the abuses that have occurred, regulators must go to the root of the problem and eliminate the conflicts that fostered this unethical and illegal behavior.

## What Should Congress Do?

**First, Congress should stop consideration of bills that weaken consumer protections.** We urge Congress not to enact proposals championed by powerful segments of the insurance industry and the leadership of the House Financial Services Committee that would deregulate insurance. The most prominent of these proposals is a "discussion draft" released earlier this year by Representative Michael Oxley, the Chair of the Financial Services Committee, and Representative Richard Baker. This proposal increases the federal role in insurance regulation while overriding many of the most important consumer protections that exist at the state level, such as the regulation of insurance rates. This would leave millions of consumers vulnerable to price gouging, as well as abusive and discriminatory insurance classification practices. It would also encourage a return to insurance redlining, as deregulation of prices would include the lifting of state controls on territorial line drawing. States would also be helpless to stop the misuse of risk classification information (for pricing purposes), such as credit scores, territorial data and the details of consumers' prior insurance history. The draft bill goes so far as to completely deregulate cartel-like organizations such as the Insurance Services Office and the National Council on Compensation Insurance, while leaving the federal antitrust exemption fully intact.

What the draft does not do is as revealing as what it does require. It does not create a federal office to represent consumer interests, although the draft creates two positions to represent insurer interests. It takes no steps to spur increased competition in the insurance industry, such as providing assistance or information to the millions of consumers who find it extremely difficult to comparison shop for insurance, or eliminating the antitrust exemption that insurers currently enjoy under the McCarran-Ferguson Act. Insurers are not required to meet community reinvestment requirements, as banks are, to guarantee that insurance is available in underserved communities. Nothing is done to prevent insurers from using inappropriate information, such as credit scores or a person's income, to develop insurance rates.

The draft does not establish minimum federal consumer protections or empower a federal regulator to investigate and prosecute the kind of abuses uncovered in Attorney General Spitzer's investigation.[7] As mentioned above, the Spitzer investigation reveals that anticompetitive practices in the industry can snare even the most sophisticated buyers of insurance. By further deregulating the industry, the Oxley-Baker proposal would lead to even more anti-consumer abuses. Federal involvement should increase consumer protections, not gut them.

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[7] (For more information, see CFA's letter to Congressional leaders at: http://www.consumerfed.org/oxley-baker_proposal.pdf.)

**Second, consider a federal minimum standards bill for states to enforce**. If there is to be a federal standards approach, the standards must be high. (See attached list of recommended provisions for such a bill). Standards based on the best state regulation has to offer -- not the worst -- should be the focus.

An example of an effective federal approach is Senator Hollings' bill (S. 1373) to establish minimum national standards based on the California regulatory system that all insurers must meet. Research by CFA has shown that California's Proposition 103, passed by the people of the state in 1988, offers the most effective regulation in the nation. For example, since 1989, auto insurance rates are up by 30 percent nationally, but have dropped by eight percent in California. The California model has proven that tight regulation and vigorous insurance competition (California does apply its anti-trust laws to insurance) cannot only coexist but can mightily succeed. We support S. 1373's prior approval mechanism, annual market conduct exams, the creation of an office of consumer protection and the enhanced competition that enhanced consumer information and repeal of the anti-trust exemption would bring. This combination of regulatory and competitive initiatives would likely have headed off scandals of the sort Spitzer has uncovered.

However, even with good standards, a federal approach is fraught with risk, given the lack of federal insurance regulatory expertise and the strong possibility that sooner or later any federal regulator would be subject to the same kind of regulatory capture that has occurred at the state level. Thus, it is essential that any federal approach mandate strong, well-funded structures to represent the needs of consumers. One model might be the Texas Office of Public Insurance Counsel, which was formed to represent insurance consumers before the insurance department. It is a separate entity, outside of the insurance department, that appears at hearings to present the consumer view on issues. Another model would be utilities public advocates, which exist in many states. A third model is California's consumer participation program under which consumers can intervene in public policy issues and rate cases to represent the consumer interests and receive funding if they make a substantial contribution to the case's outcome.

**Third, unleash the FTC**. Under the McCarran Ferguson act of 1945, states are given sole authority to regulate insurance. Insurers are also granted an exemption from federal antitrust laws that prohibit anti-competitive practices, such as colluding to set rates. The FTC is forbidden from prosecuting antitrust or consumer protection violations related to the business of insurance. However, until 1981, the FTC was allowed to investigate and study problems in the insurance industry and to then make enforcement recommendations to state regulators. In response to a FTC investigation and report that was very critical of whole life insurance products, Congress prohibited FTC investigations on most insurance matters and only allowed the FTC to conduct studies of the industry if specifically requested to do so by a Congressional Committee.[8]

[8] The FTC Improvements Act of 1980 allows the FTC to study an insurance issue only upon a specific request by a majority of either the Senate or House Commerce Committees [15 USC 46(i)]. This Act also still allows the FTC to use its investigative and reporting powers to examine a minor set of issues: antitrust activities not allowed under the broad antitrust exemption granted to insurers in the McCarran Ferguson Act.

In the long run, the FTC should be allowed to prosecute unfair and deceptive practices in the insurance industry. In the short term, Congress should immediately allow the FTC to investigate and report on insurance abuses and to offer recommendations for enforcement actions to the states.

**Fourth, repeal the anti-trust exemption**. The question is: has the insurance industry's anti-trust exemption outlived its uselessness? The history of the insurance marketplace is replete with anti-competitive agreements and joint price-fixing arrangements. A history of the insurance anti-trust exemption and the state/federal issues involved in insurance regulation can be found in the Committee Report for legislation reported out of the House Judiciary Committee in 1994 that would have partially scaled back the antitrust exemption.[9]

As this history makes clear, insurance companies have, at times, favored state regulation of insurance and, at other times, favored federal regulation, depending upon which one was less rigorous at the moment. It is also clear that Congress intended to enact a short-term moratorium on enforcement of the antitrust laws when McCarran Ferguson was enacted in 1945, not a permanent ban. The House and Senate approved different versions of McCarran Ferguson without the benefit of committee hearings on the measure.

> Within 2 weeks of the bills *(sic)* introduction, and without holding any hearings on the new measure, the Senate had passed it… The House Judiciary Committee also approved the bill without the benefit of hearings… And it was in the conference committee that the seeds were sown for the current congressional debate over competition policy and the McCarran-Ferguson Act. The conference committee proceeded to drastically transform what had been a limited moratorium into a permanent antitrust exemption for the insurance industry… The House approved the conference report without debate. The sole expression of the Houses *(sic)* intent regarding the conference report containing the new section 2(b) proviso is the statement of House managers of the conference, which indicates the House managers intended only to provide for a moratorium, after which the antitrust laws would apply. The Senate, in contrast, debated the conference report for 2 days. After repeated assurances that the proviso was not intended to preclude application of the antitrust laws, the Senate passed the bill; and President Roosevelt signed it into law on March 9, 1945.[10]

Insurance is therefore largely exempt from federal anti-trust law application. Only a handful of state anti-trust laws apply. And even in those jurisdictions, rules allowing joint action often are in place.

Testimony before the House Judiciary Committee in 1993 makes clear that an anti-trust exemption is not required for the insurers to obtain historic data compilations.[11] But current manipulation of these data, such as trending claims into the future, would not be allowed if the exemption were removed or scaled back. Trending claims is akin to allowing all homebuilders

[9] Insurance Competitive Pricing Act of 1994 (H.R. 9), Committee Report, October 7, 1994.
[10] Ibid, pages 23-25 in Lexis-Nexis online version (page numbers may not correspond to original).
[11] Insurance Competitive Pricing Act of 1993: Hearing on H.R. 9 before the Subcommittee on Economic and Commercial Law, House Judiciary Committee. Testimony of Assistant Attorney General Ann K. Bingaman, Consumers Union Legislative Director Linda A. Lipsen.

to get together and agree on the costs of supplies and labor in the coming year in setting prices for construction. This anti-competitive joint manipulation of data would be called price fixing in most other industries and must end.

**Fifth, require transparency so consumers can compare insurance products**. For 20 years, consumer advocates have called for disclosure similar to the energy efficiency ranking you see when shopping for a refrigerator. This disclosure shows, for example, that a particular unit uses 1000 BTUs, and the average for models like this is 800 BTUs. People understand right away that this is an inefficient refrigerator. CFA would suggest a point-of-sale disclosure of insurance policy value. The disclosure would show the expected payouts per dollar of premium; how much for claims, commissions, overhead, profit and so forth. Commissions could be split into regular commissions and contingent commissions. Actuaries know these figures because they are used to set rates. Right next to the various figures would be displayed the same information for the overall industry. This information is also readily available from sources such as the NAIC and A.M. Best & Co. Consumers could focus upon the part of the premium expected to be paid out in losses. This is known as the "loss ratio." So, if the policy a consumer was considering was expected to pay out 50¢ per $1.00 in claims but the industry average were 70¢, the consumer would know that it was a bad deal, an "inefficient" (costly) deal.

I would be happy to respond to your questions at the appropriate time.

## *WHY INSURANCE IS AN ESSENTIAL PUBLIC GOOD, NOT SOME NORMAL PRODUCT THAT CAN BE REGULATED SOLELY THROUGH COMPETITION*

1. ***Complex Legal Document***. Most products are able to be viewed, tested, "tires kicked" and so on. Insurance policies, however, are difficult for consumers to read and understand -- even more difficult than documents for most other financial products. For example, consumers often think they are buying insurance, only to find they bought a list of exclusions.

2. ***Comparison Shopping is Difficult***. Consumers must first understand what is in the policy to compare prices.

3. ***Policy Lag Time***. Consumers pay a significant amount for a piece of paper that contains specific promises regarding actions that might be taken far into the future. The test of an insurance policy's usefulness may not arise for decades, when a claim arises.

4. ***Determining Service Quality is Very Difficult***. Consumers must determine service quality at the time of purchase, but the level of service offered by insurers is usually unknown at the time a policy is bought. Some states have complaint ratio data that help consumers make purchase decisions, and the NAIC has made a national database available that should help, but service is not an easy factor to assess.

5. ***Financial Soundness is Hard to Assess***. Consumers must determine the financial solidity of the insurance company. One can get information from A.M. Best and other rating agencies, but this is also complex information to obtain and decipher.

6. ***Pricing is Dismayingly Complex***. Some insurers have many tiers of prices for similar consumers—as many as 25 tiers in some cases. Consumers also face an array of classifications that can number in the thousands of slots. Online assistance may help consumers understand some of these distinctions, but the final price is determined only when the consumer actually applies and full underwriting is conducted. At that point, the consumer might be quoted a much different rate than he or she expected. Frequently, consumers receive a higher rate, even after accepting a quote from an agent.

7. ***Underwriting Denial***. After all that, underwriting may result in the consumer being turned away.

8. ***Mandated Purchase***. Government or lending institutions often require insurance. Consumers who must buy insurance do not constitute a "free-market", but a captive market ripe for arbitrary insurance pricing. The demand is inelastic.

9. ***Incentives for Rampant Adverse Selection***. Insurer profit can be maximized by refusing to insure classes of business (e.g., redlining) or by charging regressive prices.

10. ***Antitrust Exemption***. Insurance is largely exempt from antitrust law under the provisions of the McCarran-Ferguson Act.

Compare shopping for insurance with shopping for a can of peas. When you shop for peas, you see the product and the unit price. All the choices are before you on the same shelf. At the checkout counter, no one asks where you live and then denies you the right to make a purchase. You can taste the quality as soon as you get home and it doesn't matter if the pea company goes broke or provides poor service. If you don't like peas at all, you need not buy any. By contrast, the complexity of insurance products and pricing structures makes it difficult for consumers to comparison shop. Unlike peas, which are a discretionary product, consumers absolutely require insurance products, whether as a condition of a mortgage, as a result of mandatory insurance laws, or simply to protect their home or health.

*Consumer Principles and Standards for Insurance Regulation*

1. **Consumers should have access to timely and meaningful information about 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 the average consumer sufficient to educate and enable consumers to assess a particular policy and its value should be required for all insurance; it should be standardized by line to facilitate comparison shopping; it should include comparative prices, terms, conditions, limitations, exclusions, loss ratio expected, commissions/fees and information on seller (service and solvency); it 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 an 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.
    - A free look period should be required; with meaningful state guidelines to assess the appropriateness of a 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). The insurer should give the consumer notice of feedback procedure at the end of the 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 the 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 insurance 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 authorities 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, and 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 an 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 purposes other than the one 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 is needed to complete the 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 a clear set of standards for maintaining the 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 the sharing of the data.
   - Protections should not be denied to beneficiaries and claimants because a policy is purchased by a commercial entity rather than by an individual (e.g., a worker should get privacy protection under workers' compensation).

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

- Aggrieved consumers must have the ability to hold insurers directly accountable for losses suffered due to their actions. UTPAs should provide private cause of action.
- Alternative Dispute Resolution clauses should be permitted and enforceable in consumer insurance contracts only if the ADR process is: 1) contractually mandated with non-binding results, 2) at the option of the insured/beneficiary with binding results, or 3) at the option of the insured/beneficiary with non-binding results.
- Bad faith causes of action must be available to consumers.
- When regulators engage in settlements on behalf of consumers, there should be an external, consumer advisory committee or other mechanism to assess fairness of settlement and any redress mechanism developed should be an 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 a 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.
- Regulators should focus on online monitoring and certification to protect against fraudulent companies.
- A department or division within the 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. NAIC is implementing this.)
- 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 the regulatory entity must be subject to judicial review with the burden of proof on the 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., providing a 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 the 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 the 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, a national partnership, or "one-stop" approval, there must be a national consumer advocate's office created to represent the consumers of all states before the national treatment state, the one-stop 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 a well-established structure for ongoing dialogue with and meaningful input from consumers in the state, e.g., a consumer advisory committee. This is particularly true to ensure that the needs of certain populations in the state and the needs of changing technology are met.