STATE INSURANCE REGULATION

HEARING

BEFORE THE

SUBCOMMITTEE ON
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OF THE

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STATE INSURANCE REGULATION

TUESDAY, OCTOBER 9, 1979

U.S. SENATE,
SUBCOMMITTEE ON ANTITRUST, MONOPOLY
AND BUSINESS RIGHTS,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2 p.m. in room 5110, Dirksen Senate Office Building, Senator Howard M. Metzenbaum (chairman of the subcommittee) presiding.

Present: Senators Metzenbaum and Thurmond.

Also present: Herman Schwartz, chief counsel and staff director, Subcommittee on Antitrust, Monopoly and Business Rights; Stewart W. Kemp, special counsel; Marilyn Falksen, chief clerk, and Peter Chumbris, minority consultant.

OPENING STATEMENT OF SENATOR METZENBAUM

Senator METZENBAUM. Today the Subcommittee on Antitrust, Monopoly and Business Rights continues its examination of the operation of the insurance business under the McCarran-Ferguson Act. We will focus on the effectiveness of State insurance regulation.

Since the mid-19th century, the States, rather than the Federal Government, have regulated the insurance industry. Congress voted in 1945 to continue this system despite the fact that the Supreme Court had reversed a longstanding precedent which had denied Federal jurisdiction. I am pleased to note that the crowd is screaming favorably in support of what I am saying. [Laughter.]

Every State now has an extensive set of laws governing insurance and a commissioner and staff to implement them. The budgets of all the State insurance departments come to more than $120 million per year. How good a job are the States doing? How well are they protecting the interests of insurance consumers?

I chaired hearings in early 1978 which raised serious questions about State insurance regulation. Numerous witnesses testified to serious problems of unfair discrimination and availability. Extensive testimony demonstrated that property casualty companies are systematically rejecting many clean, loss-free risks.

Underwriting guidelines from several companies showed that they discriminate routinely on the basis of occupation, marital history, and even personality. Musicians and waiters are automatically bad risks at one company. Another increased the rates of one of its insured by 86 percent solely because her husband died. Yet a company executive admitted that these criteria were used even though they have not been statistically verified.

Other consumers complained about widespread redlining. One witness reported that she and her neighbors were unable to obtain homeowners insurance even though they lived in a middle-class neighborhood with homes in excellent condition.

Rates 50 and 100 percent above normal market levels were reported for many consumers with perfect records. An insurance commissioner testified that a wealthy suburbanite with several accidents could pay as little as $200 for full auto insurance coverage. Identical coverage for an identical car would cost $2,500 for another driver with a perfect record for over 7 years—if that driver happened to be male, 24 years old, and a resident of an urban neighborhood.

Testimony along these lines came from witnesses all over the country. The hearing stimulated an enormous public response. Large numbers of citizens wrote in to relate similar problems with insurance companies. The extent of these problems raises critical questions.

Is State regulation of the insurance industry effective? Is Congress' current delegation of responsibility to the States appropriate? More information is needed to help Congress evaluate these issues and develop a comprehensive national policy on insurance.

Key issues are the following: Are the States collecting the hard data necessary to determine the extent of problems like redlining, unfair rate differentials, and arbitrary discrimination? Are they scrutinizing the data—systematically and carefully—to determine whether insurer practices conform to the statutory mandates that rates not be excessive, inadequate, or unfairly discriminatory? Is there a need for Federal legislation, and if so, what kind? In that connection, let me clarify the status of a proposal that has been circulating for some weeks.

A member of my staff prepared a draft of a bill for my consideration. That bill has been disseminated more widely than we had anticipated. I want to take this opportunity to make clear that the draft is a preliminary staff study bill and does not necessarily represent my views, for I am still studying the matter.

Shortly after our hearings last year, I asked the General Accounting Office to study the operation of State regulation. A copy of my letter to GAO will be put into the record. Today, they have issued a 275-page report[1] that looks very comprehensive and thorough. To explore the issues and conclusions of this report, the subcommittee has invited the GAO to this hearing.

[The letter referred to above follows:]

U.S. SENATE,
SUBCOMMITTEE ON CITIZENS
AND SHAREHOLDERS RIGHTS AND REMEDIES,
COMMITTEE ON THE JUDICIARY,
Washington, D.C., March 9, 1978.

Hon. ELMER B. STAATS,
Comptroller General of the United States,
Washington, D.C.

DEAR MR. STAATS: As chairman of the Senate Judiciary Subcommittee on Citizens and Shareholders Rights and Remedies, I recently presided over 2 days of hearings on discrimination in insurance. These sessions produced evidence that property and casualty insurance companies use rating and underwriting criteria—such as age, sex, marital status, territory, and occupation—which unfairly discriminate against whole classes of consumers.

The insurance problems of American citizens raised at our hearings and subsequently revealed by the enormous public response we have had to the Subcommittee's examination of insurance practices suggests a critical question: is

[1] The GAO report "Issues and Needed Improvements in State Regulation of the Insurance Business" is on file with the committee.

state regulation of the insurance industry effective? City, county, and state officials as well as individual consumers answered emphatically "no" at the hearings. A number of witnesses, including a state insurance commissioner, called for repeal of the McCarran-Ferguson Act. The statute not only exempts the insurance industry from federal antitrust regulation, but over the years the executive branch has treated it as largely preemptive of all federal regulation.

I understand that the General Accounting Office is presently considering whether to conduct a survey of state insurance departments. I am writing to urge you to conduct the survey as part of an evaluation of the nature and effectiveness of state regulation of insurance.

The enormous response to the Subcommittee's hearings suggests to me that consumers in increasing numbers are challenging the way insurance companies conduct their businesses and the responses of state governments to these practices. A GAO survey could provide much of the basic information necessary to evaluate how the federal government should react to these criticisms in the development of a comprehensive national policy on insurance.

The staff of the Subcommittee will be available to work with you and your staff in developing the questionnaire and in suggesting possible subjects for in-depth examination.

GAO's reputation for thoroughness and impartiality particularly suits your organization for this kind of undertaking. I am available to discuss my recommendation in favor of the survey at any time.

Very sincerely yours,

HOWARD M. METZENBAUM, *Chairman.*

Senator METZENBAUM [continuing]. We have with us Harry S. Havens, Director, program analysis; Allan Mendelowitz, senior economic specialist, and Mark V. Nadel, senior analyst.

We will recess at this time. In the event Senator Thurmond returns prior to the time that I do, I will ask him to reconvene the meeting and to go forward with his opening statement.

[A brief recess was taken.]

Senator METZENBAUM. The committee will come to order. I want to apologize, but I had no choice under the circumstances.

OPENING STATEMENT OF SENATOR THURMOND

Senator THURMOND. Mr. Chairman. I shall not make a full opening statement today, since I feel that I first need to see the full thrust of this new direction of hearings on the jurisdiction of the regulation of the insurance business.

Late Friday afternoon, our office received a copy of a report to the Congress by the Comptroller General which contained 275 printed pages of data, tables, and appendixes and a copy of an Executive summary of 52 printed pages, which I saw for the first time this day. Obviously, it will take quite a bit of time to digest its contents. I note with interest, however, the report's comments on issues and needed improvement in State regulation of the insurance business.

Some of the issues raised in the report have been raised previously since the Senate Antitrust Subcommittee began hearings on insurance in 1958. The printed hearings to date are contained in volumes 1 through 19 of the hearings, exclusive of the separate hearings held on "health insurance" and later on "life insurance" to date.

I do not wish to prejudice today's hearings but I must state, as I have stated several times this year in the "life insurance" hearings, that I tend to support State regulation of insurance rather than Federal regulation.

Mr. Chairman, I ask unanimous consent that my remarks made on May 1, 1974, at page 12577 of the Congressional Record, in which I supported State regulation over Federal regulation on the Federal no-fault insurance bill, S. 354, be included as a part of the record of these hearings. I also joined the minority report on S. 354, more fully explaining my views on the issues.

[Senator Thurmond's remarks follow:]

[From the Congressional Record—Senate, May 1, 1974]

Mr. THURMOND. Mr. President, I rise in opposition to the Federal no-fault insurance bill, S. 354, and in favor of the motion to recommit by the distinguished and able Senator from Nebraska (Mr. Hruska).

I joined in the minority report on S. 354 urging defeat of the Federal no-fault insurance bill for the very sound reasons enumerated in that report. Additionally, I have submitted brief individual views which strongly declare a basic constitutional objection to S. 354. This objection is embodied in the 10th amendment to the Constitution.

The 10th amendment very simply states that:

"The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

Mr. Chief Justice Stone, speaking of the 10th amendment in *New York* v. *United States*, 326 U.S., at page 587, stated:

"The National Government may not interfere unduly with the State's performance of its sovereign functions of government."

Justices Black and Douglas in the same case, at page 594, stated:

"The notion that the sovereign position of the States must find its protection in the will of a transient majority of Congress is foreign to and a negation of our constitutional system. There will often be vital regional interests represented by no majority in Congress. The Constitution was designed to keep the balance between the states and the Nation outside the field of legislative controversy."

Mr. President, if we ignore the 10th amendment and these very sound opinions, then our 50 States will be in grave danger.

S. 354, in my opinion, is a bill which is unconstitutional. It is a bill which will reverse the congressional policy established in 1945 in the McCarran-Ferguson Act. It is a bill that will hurt the small business insurance companies that operate in less than six States, but will aid the giant national insurance companies operating in most of the 50 States. It is a bill, that if passed into law, will not only destroy sovereignty and regulation, but will open the door to passage of even more disastrous laws relegating the States to a position of impotency.

Mr. Justices Black and Douglas in New York against United States, at page 592, make the above point by quoting President Woodrow Wilson as follows:

"The States of course possess every power that government has ever anywhere excercised, except only those powers which their own constitutions or the Constitution of the United States explicitly or by plain inference withhold. They are the ordinary governments of the country; the Federal Government is its instrument only for particular purposes. As stated in *U.S.* v. *Railroad Co.*, 17 Wall 322, 327–328, the right of the States to administer their own affairs through their legislative, executive, and judicial departments, in their own manner through their own agencies, is conceded by the uniform decisions of this Court and by the practice of the Federal Government from its organization."

I urge my colleagues in Congress to think seriously of the dangers to the sovereignty of the States if S. 354 is enacted.

Mr. President, on the grounds of constitutionality, as well as on the grounds that it is simply unwise, I hope Congress votes no to S. 354. The wise course, and the constitutional course is to permit the States to continue their fine efforts of passing first-party no-fault insurance laws. To date, 20 States have passed no-fault legislation. Additionally, there is a voluntary plan in effect in the State of Washington. Other State legislatures are presently considering the matter, and, in my opinion, they should be permitted to continue this consideration, keeping in mind the special needs and problems of each State.

Mr. President, in addition to the grave constitutional issues presented by S. 354, I would like to emphasize the cost factor of this proposed legislation. Significant in my mind is the data in appendix E and appendix G of the minority report which shows that the citizens of South Carolina could be paying increased premiums from 14 percent to 34 percent, depending upon the coverage obtained.

If the owner of a vehicle lives in a rural area or if the vehicle is a private vehicle rather than a commercial one, then increased premiums would be even higher.

The higher premium costs will affect at least 44 States. These statistics are alarming to me and to many others. The proponents of Federal no-fault auto insurance have been telling the press and the people that one of the key factors of Federal no-fault is the significant reduction of auto insurance premiums that could be anticipated. This is simply not the case. Instead of significant reductions of premiums, my constituents and the people of at least 43 other States will be forced to pay significant increases in auto insurance premiums.

Mr. President, it is clear that the proposed legislation could have disastrous and far-reaching consequences. I hope my colleagues will give this matter the most careful consideration, and I hope they will see fit to recommit the bill.

Mr. President, in the 20 years I have been in the Senate, I have witnessed the Senate going into one new field of activity after another, and without constitutional authority. This is another example of Congress attempting to go into a new field of activity, without constitutional authority. If one will search the Constitution, he will find no authority in the Constitution for Congress to go into the field of no-fault insurance.

Many other fields have been gone into. Bad precedents have been set. But that is no reason now to inject the Federal Government into another new field of activity where it has no constitutional authority.

If we are going to be a law-abiding people, Congress ought to set the example and ought to abide by the Constitution, so that the people of the country will know that we are law-abiding, that we favor the Constitution, and that the laws we enact will be in accordance with the Constitution.

Senator METZENBAUM. Mr. Havens, we are very happy to hear from you at this point.

You are accompanied by Mr. Mendelowitz and Mr. Nadel. If you have a written statement, and if you are prepared to read it in its entirety, fine. If you care to summarize, that will be acceptable. The choice is yours.

Mr. HAVENS. In the interest of time, it might be preferable if I summarize it and hit the high spots, with the full statement placed in the record.

PANEL OF GAO OFFICIALS:

STATEMENTS OF HARRY S. HAVENS, DIRECTOR, PROGRAM ANALYSIS DIVISION; ALLAN MENDELOWITZ, SENIOR ECONOMIC SPECIALIST, PROGRAM ANALYSIS DIVISION; AND MARK V. NADEL, SENIOR ANALYST, PROGRAM ANALYSIS DIVISION

Mr. HAVENS. We are pleased to be here, Mr. Chairman, to discuss GAO's study of the regulation of the insurance business by State insurance departments. This afternoon, I would like to summarize our findings in four related areas: The regulation of automobile insurance risk classification; insurance availability; trade practice regulation; and the appropriate degree and extent of regulation of the price of automobile insurance.

With respect to personal risk classifications, it is important to recognize that the price which a person pays for automobile insurance depends upon age, sex, marital status, place of residence, and other facts. Relative rates with respect to age, sex, and marital status are based on the analysis of national data.

A youthful male driver, for example, is charged twice as much as an older driver, all over the country. None of the State insurance departments we visited conducted a regular independent, actuarial

analysis of these personal classification relativities to establish whether they are valid in its State. The State departments do not normally collect and analyze the information necessary to make these judgments on either a statewide basis or with respect to specific parts of their State.

Similar problems exist with a system of territorial rating. Most departments do not have sufficient information to evaluate whether or not the territorial boundaries used by insurance companies are fairly and accurately drawn.

Another aspect of geographic or territorial rating relates to redlining in the area of insurance availability. It has also been claimed that insurance companies engage in redlining, the arbitrary denial of insurance to everyone living in a particular neighborhood. We found that most States do not either systematically collect data or conduct special studies to determine whether redlining exists.

Underwriting is a subjective practice, distinct from these previously discussed more objective distinctions among people. These underwriting practices also affect availability. For example, some underwriting manuals list as objectionable such occupations as painter, automobile dealer, and waiter. Only 26 percent of those responding to our questionnaire reported that they had the authority to forbid the use of particular guidelines. Few State departments even review or collect underwriting guidelines used by insurance companies. Furthermore, most States provide only limited protection to consumers who have had adverse underwriting decisions. Most States do not require that consumers be informed.

Senator METZENBAUM. I would just like to inquire of you at that point. What do you mean by the statement that most States provide only limited protection to consumers who have had adverse underwriting decisions?

Mr. HAVENS. The question here relates to whether the person was reasonably denied access to insurance, and whether the individual is informed as to the reasons for the denial. We found that in most cases the States do not require that insurance companies inform the individuals of the reasons of denial. Only 3 States out of the 17 where we did field work require insurance companies to provide the reasons for a rejection. Even in these cases, an explanation is required only if the individual makes a written request.

With respect to cancellation, nearly all States protect consumers against arbitrary cancellation once a policy has been in force 60 days. The protection provided policyholders by States is somewhat better with respect to cancellations and nonrenewals. With respect to nonrenewals, however, only 15 States require that the reason accompany the notice. Fourteen States require that the reasons be given at the request of the insured. The remaining 21 States and the District of Columbia have no statutory requirements to explain the nonrenewal.

Moving to the area of trade practice regulation, we were concerned about the lack of systematic procedures in this area. There was a lack of systematic procedures for handling consumer complaints and trade practice surveillance in most of the departments in our sample. Most of them followed up on consumer complaints but have only limited authority to do anything about them. Most departments have been responsive to the recommendations of the NAIC that they will undertake market conduct examination. However, based on the examination

reports that we reviewed, market conduct examination process needs considerable improvement.

For example, the NAIC "Handbook For Examiners" recommends that examination results be compared to minimum qualitative standards to determine relative company performance. However, none of the market conduct examination reports we reviewed explained what the standards were or identified if such standards were used to assess company performance.

Without set guidelines, it is impossible to tell whether the actions by companies constitute a serious pattern of unfair practices or only an unacceptable number of innocent mistakes.

The procedures used to monitor insurance company claims handling also needs substantial improvement. None of the departments we visited monitors claims handling on a continuous or periodic basis other than in examinations—normally every 3 years. Only 1 of the 17 fieldwork States, Wisconsin, regularly contacts a sample of policyholders and claimants as part of the examination process.

In short, the insurance regulatory process needs more and better information and more systematic procedures to assure that consumers receive adequate protection.

Senator METZENBAUM. In your statement, I notice you make the point that you found that the reviews of the insurance company claims handling that had been done by the insurance commissioners only include the company's perspective, not the consumer's. I gather you mean that they just never get in touch with the consumers to find out what the nature of the problem is?

Mr. HAVENS. That is correct, sir, except in the case of Wisconsin which does contact a sample of the consumers to find out if they have had problems or have any particular information of significance for examination.

With respect to price regulation, we concluded that less regulation rather than more may be a viable option. On the average, we found almost no difference in automobile insurance costs between States that have prior approval price regulation and those that do not. We believe that it may not be necessary for the Government to regulate the base price of automobile insurance except in assigned risk plans. However, differentials between various classes of risks and the validity of the classifications themselves need greater attention by the States.

In general, we believe that consumers could be better served if insurance departments devoted fewer resources to price regulation and more resources to regulation designed to allow competitive forces to work more effectively.

Senator METZENBAUM. Isn't it a fact, Mr. Havens, that although the departments have authority with respect to price regulation and they spend a lot of time in this area, they get filings that come from the rate bureaus, such as ISO, which are pretty much controlled by the insurance industry, and as a practical matter, there is very little regulation of rates as such; is there?

Mr. HAVENS. Well, I think that does vary widely among States. In some State they take a very aggressive role with respect to rates. Texas, for example, does an original actuarial analysis on its own and determines the rate to be allowed based on its analysis, and Massachusetts has restructured the classification system to affect the rates applicable to certain classes of individuals; so I don't think it is

fair to characterize that the States as a whole do not pursue active rate regulation.

Senator METZENBAUM. I would agree with that statement.

Mr. HAVENS. Our conclusion was that rate regulation of the base insurance rate did not have much effect, whether it existed or not. But that doesn't mean the insurance departments weren't pursuing it aggressively.

One major problem with respect to competition is that consumers simply don't have enough information to bring about effective competition. In this connection, we believe that insurance departments should do more to disseminate more information about comparative insurance prices and indicators of the quality of companies.

We believe that competition can more effectively achieve the lowest possible base prices, but we also realize that regulation may be necessary to prevent the use of unfairly discriminatory rate differences.

In conclusion, we have not attempted to conduct a comprehensive evaluation of all facets of insurance regulation. Based on the work we did, however, we conclude that a number of problems in insurance regulation need to be remedied. Many alternatives are available to that end: Reform by the States themselves, a standby Federal role, or repeal of the McCarran-Ferguson Act and active Federal regulation.

We hope our report will assist the Congress and the public in evaluating these alternatives.

We would be happy to answer any questions you may have.

Senator METZENBAUM. I notice that one of the alternatives that you didn't mention was the establishment of specific minimum Federal standards. I gather that that is in your statement and is your position.

Mr. HAVENS. It certainly is, sir, an option.

Senator METZENBAUM. As you looked at the insurance regulatory process—your statement indicates that it needs more and better information and more systematic procedures if the consumer is ever to receive adequate protection. Is that generally what your conclusions are?

Mr. HAVENS. Yes, sir.

Senator METZENBAUM. In your report you state that there are serious shortcomings in State insurance regulation. Would you care to amplify that conclusion?

Mr. HAVENS. Well, basically we discuss them at some length in the report which is itself fairly lengthy. I think in general they come down to the points that you just mentioned—lack of data available to the insurance departments in many cases to ascertain the validity of the decisions being made and a lack of systematic procedures for handling information that they have available to them.

Senator METZENBAUM. Did you find any areas in which the States are doing an excellent job, a very good job?

Mr. HAVENS. Well, it ranged widely, of course, from State to State. We found in almost every State that we visited that they were doing a number of things quite effectively and, at the same time, we found very few areas, if any, where it is reasonable to say that all the States were doing an equally effective, satisfactory job.

Senator METZENBAUM. You studied how many State insurance departments, Mr. Havens?

Mr. HAVENS. We sent a questionnaire to all 50 States plus the District of Columbia. We received responses from 45. In addition to the responses to the questionnaire, we visited 17 States and did fairly detailed field work in those 17 States.

Senator METZENBAUM. Generally speaking, do you have any opinion as to whether or not in the main insurance departments seem to consider their responsibility being an adjunct of the insurance industry, or did you find any strong evidence of consumer concerns? As a general rule, not with respect to specifics?

Mr. HAVENS. I don't think it would be fair to generalize on that. I think the insurance departments and the insurance commissioners recognize at least the principle that they have two parallel areas of responsibility both ultimately related to the ability of the industry to serve the consumer.

First they have the responsibility of insuring the financial integrity and solvency of the industry, without which the consumer is left without insurance. In addition, they have the responsibility to assure that the consumer is not subject to unfair practices or to unfair discrimination and so on. I think in general the commissioners do recognize that responsibility. I don't think I would care to generalize as to an overall characterization as to how well they, in fact, perform that fairly delicate balancing act. Some do it better than others, I think, some place more emphasis on consumer protection aspects than others.

Senator METZENBAUM. Looking at State insurance department resources, I note that you found the total of all State insurance department budgets to be $122 million. How does that compare with Federal regulatory agencies?

Mr. HAVENS. In 1978, the Federal Trade Commission and the Securities and Exchange Commission each had a budget of about $62 million. The Interstate Commerce Commission had a budget of about $65 million.

Senator METZENBAUM. So your conclusion is that there is adequate funding to do the job and that there is a recognition of the responsibility, but you have some concern whether or not that responsibility is being lived up to; is that a fair way of synopsizing your position?

Mr. HAVENS. Well, with respect to the resources, I guess my question would go less to the issue of whether they recognize the responsibilities and live up to them or whether the resources that are available are being used in the most effective way possible. We suggest, of course, that there be less attention to base price regulation and more attention to other aspects of regulatory oversight so we would prefer, I think, some reallocation of those resources.

However, it must be recognized that the insurance departments are limited in their flexibility by State law and that if a State law does require them to regulate rates, they must put the resources in that to carry out that statutory responsibility.

Senator METZENBAUM. I gather that in the area of financial regulation or insuring solvency, the primary focus is one of solvency of the companies rather than the question of rates to the consuming public. Is that pretty much accurate?

Mr. HAVENS. Well, I think the focus of the financial solvency regulatory activity, insofar as it relates to rates, is to insure that the rates are adequate to maintain the solvency of the firm and, therefore, its

ability to continue to offer insurance to the public and to make good on the insurance that it has contracted for so that the rates are an issue, but it is from the perspective of maintaining the solvency of the company which, of course, is fundamental to the company's ability to serve the public.

Senator METZENBAUM. In order to do the job of specialized examination of rates, did you find that the States had the capacity to perform computerized audits concerning those rates and the company's solvency and the kind of qualified personnel who can do this job in the manner in which it should be done?

Mr. HAVENS. Well, it seems to us reasonably clear that there are substantial differences between different lines of insurance that would suggest the need for specialized examination procedures and, thus, for specialized examination personnel. This is most obvious, for example, in the difference between life companies and property and casualty companies where the business practices and the actuarial calculations are quite different.

We believe that some specialization would be desirable in this area and, in addition, since so much of the financial data of the companies is on automatic data processing equipment, we believe that the ability to audit or review the computer records, rather than being confined to hard copy, would be desirable.

Senator METZENBAUM. And did you find that that exists?

Mr. HAVENS. In some—perhaps, half the States—there were specialists available in the life area and property casualty area, and I guess that of 17 percent of the States, 8 out of the 43 reporting, I reported that they had computer software audit and review capability.

Senator METZENBAUM. Now, as I understand it, in your examination of the 17 States that were studied in depth, you included those with the largest departments and none of the 20 States with budgets under $1 million. Does that mean that your findings are based on the States with the largest staffs and budgets rather than the average State?

Mr. HAVENS. It certainly is fair to conclude that our field work findings—the detailed findings that we collected out of onsight visits—came from the largest departments. Whether they are average or not, I think is very difficult to tell. They are not average in terms of size, sir. But neither do I think it is fair to assume that because they were the largest they were automatically the best or automatically the most sophisticated or any of that. A large State needs a larger regulatory activity than a smaller State; that doesn't mean that the larger State has a better department or that it is any less or more typical than the smaller State.

Senator METZENBAUM. But the fact is that the same kinds of companies come into the large States as come into the small States, so that the State with the smaller budget has a lesser chance of being able to do the job that has to be done. Wouldn't that be a logicial conclusion?

Mr. HAVENS. Well, first of all, I think you would find that the larger States had a disproportionate share of companies domiciled in the State and, therefore, companies for which they had particularly extensive financial solvency regulatory responsibilities, so that I don't think size really is an indicator of much except that the larger

States tend to have a broader range of problems to deal with than the smaller States.

Senator METZENBAUM. Mr. Havens, I will have to excuse myself again. The committee will stand in recess for another rollcall. For the record, I will ask you that same question over again. Mr. Havens, what is the average number of CPA's, attorneys, and actuaries in each department?

Mr. HAVENS. The average on CPA's is zero. We found a total of 16 States that have CPA's, 11 have 1 and 5 have 2 or more. Attorneys, the average is two. For actuaries, that is, members of the Society of Actuaries, or the Casualty Actuarial Society—the average is one. The largest States average two, the remaining States average less than one.

Senator METZENBAUM. How many States maintain a system whereby complaints are coded, analyzed, and used systematically in the examination process?

Mr. HAVENS. I can only answer that question with respect to the 17 States in which we did fieldwork—out of those 17, 6 maintain such a system.

Senator METZENBAUM. The other 11 do not?

Mr. HAVENS. That's correct.

Senator METZENBAUM. I believe that in your report you addressed yourself to an evaluation of the State market conduct examinations which you examined. Would you state your findings on this point, please?

Mr. HAVENS. We reviewed 27 examinations in 13 of the States in which we did fieldwork. We tried to pick the two most recent examinations conducted in each of those States. We compared those with the criteria suggested by the NAIC examiner's handbook and found that few, and probably none of them, actually met the full criteria suggested by the NAIC.

In essence, the problem that we found was that there was little in the way of explicit criteria which the NAIC recommended be set forth, and, therefore, it was hard to figure out what judgments were being made against which standards in each of those examinations.

Senator METZENBAUM. Concerning price regulation, how many States did you find that undertook an independent actuarial review of proposed rate increases in auto insurance?

Mr. HAVENS. I believe the answer to that is two—let me check. Yes; Texas and Massachusetts.

Senator METZENBAUM. Out of 17?

Mr. HAVENS. Out of 17; yes, sir.

Senator METZENBAUM. In those States, did the industry- or the Government-recommended rate turn out to be more accurate?

Mr. HAVENS. In general, where the State itself did an independent actuarial review, the State-recommended rates, the State-established rates, turned out to be, with hindsight, more accurate than those recommended by the Insurance Services Office or the individual firm. However, I think one has to recognize in that case that where the insurance industry recognizes that there is going to be an independent actuarial review, certain behaviorial practices creep into what they suggest which are analogous, perhaps, to what happens in the budget process where an agency may ask for more money than it actually

wants, recognizing that it is going to be cut. So it is hard to base much in the way of conclusions on simply comparing what the firms ask for and what the States approve.

Senator METZENBAUM. As a practical matter, most States do not cut rates very much, do they? With the exception of certain States, such as North Carolina, perhaps, or Texas or Massachusetts, do States pretty much accept the filings and go along with them?

Mr. HAVENS. Well, in many States, of course, there is no prior review. The States simply have a file-and-use arrangement so that there is no direct control prior to the using of the rates.

Senator METZENBAUM. Isn't that really the key to it? They file and use the rates and that's it. The States still retain the right to go back if they do an independent actuarial check, but only two States do that kind of independent actuarial check. Is the bottom line that State regulation of rates is almost nonexistent except for a couple of instances that you have highlighted?

Mr. HAVENS. Well, there are several cases, certainly, where rate regulation does have an effect as compared with the rates initially requested by the firms. In many cases, however, in most States, perhaps, it is fair to say that the State regulation of price, from the standpoint of consumer's interest, does not have much effect.

Senator METZENBAUM. Actually, it doesn't have any effect in most States, isn't that true?

Mr. HAVENS. Well, in a file-and-use State, I think it would be fair to say that competitive pressures set the rates much more effectively than State regulation.

Senator METZENBAUM. Addressing ourselves to the question of competitive pressures, what State would you choose to live in, out of the States that you examined, if you wanted to be certain that you could go to that State and say to the insurance commissioner or the insurance department, I would like to be able to compare insurance company rates and the kind of coverage they provide. What State does anything along that line?

Mr. HAVENS. Well, Massachusetts, for example, has what I would consider to be a very good policy form which is quite easily compared between companies.

Senator METZENBAUM. That is because they had a great deputy superintendent of insurance as well as a good superintendent of insurance who is no longer with that government agency.

Mr. HAVENS. I understand that Virginia puts out a very good buyer's guide allowing the purchaser to compare companies. There are, of course, ways that make it possible to compare companies that aren't a function necessarily of the State insurance departments. "Consumer's Reports," for example, puts out some pretty good comparative information allowing one to examine in particular from the standpoint of quality.

Senator METZENBAUM. But that is a private publication, "Consumer Reports," not the industry's.

Mr. HAVENS. Yes, sir.

Senator METZENBAUM. The industry itself and the insurance departments—with the exception of the few places that you mentioned—really do nothing to help the consumer buy insurance on a competitive basis, do they?

Mr. HAVENS. We concluded that there was inadequate concern for improving competition and for assuring a sound basis for competition.

Senator METZENBAUM. In the area of risk classification, how many States did you find which had undertaken a thorough and rigorous analysis of the classifications within their jurisdictions from both an actuarial and a broader social perspective?

Mr. HAVENS. Among the 17 that we visited and in which we did fieldwork, we found only Massachusetts and New Jersey which we considered had conducted such a study.

Senator METZENBAUM. So how many States had undertaken a thorough and rigorous analysis of the rate differentials among individual insureds and classes?

Mr. HAVENS. Well, I think in talking about individuals, one has to be careful that we are not talking about Bill Smith versus John Jones—we are talking about individuals who are similarly situated. In terms of analysis of rate differentials within existing classes as established by the industry—only Massachusetts had performed such a study.

Senator METZENBAUM. How many States have done a thorough and careful analysis of the territorial assignments and rate differentials used in their States?

Mr. HAVENS. Most of the States simply didn't have even the beginnings of the data necessary to examine territorial differences. For example, in order to determine whether a territory is reasonably homogeneous, and, therefore, an appropriate basis for assignment of risk, one really should find out more about the details within that territory perhaps on a ZIP code basis or on a neighborhood basis or a township basis—but it has been done occasionally on an ad hoc basis, but none that we found had done so on a systematic regular basis.

Senator METZENBAUM. Mr. Havens, a practice has grown up in the insurance industry, particularly with respect to automobile buyers, where in order to get a higher rate for the insurance, and also more profit for the automobile dealer and in some instances the bank or the financial institution that is involved, they have told the buyer that he had to have a rated policy or that he had to be in the assigned risk plan. A rated policy runs, as I understand it, about 25 to 50 percent higher than standard rates. Did you see any evidence at all in the 17 States that you checked into of any concern whatsoever by the insurance departments for this effective coercion of the automobile buyer to buy insurance on a rated basis?

Mr. HAVENS. Let me ask Mr. Nadel to respond to that question.

Senator METZENBAUM. Good.

Mr. NADEL. We can't say that there was no concern at all. We didn't specifically address that question but we did learn, for example, that in North Carolina, where such a practice apparently happens, the State insurance department has attempted to include physical damage coverage in the residual market plan but has been unsuccessful in getting that through the legislature. The details of that response by the State of North Carolina are in a letter from that State in the full report.

Senator METZENBAUM. Well, as a matter of fact, the situation in North Carolina is a rather interesting one, isn't it, in which the superintendent of insurance is very aggressive and very consumer-oriented?

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When he moved forward and put out some rules and regulations to provide that kind of consumer protection, the insurance industry was strong enough through its lobby to go to the legislature and reverse his decision—isn't that pretty much what you found?

Mr. NADEL. That was the information provided to us by the insurance department of North Carolina; yes.

Mr. HAVENS. I'd be a little reluctant to attribute the behavior of the State of North Carolina Legislature to the power of a lobby group.

Senator METZENBAUM. I know that you didn't say that, I did. I didn't mean in that way to take you down the road, but the fact is that the legislature did change the law and vitiate the effective action of the State insurance superintendent. Other than North Carolina, no States do anything about the pushing or coercing or causing of individuals to be forced into rated insurance policies, do they?

Mr. NADEL. Well, several States, Mr. Chairman, do not allow substandard companies to operate. Beyond that, sir, we did not find any evidence that States were, shall we say, aggressively informing consumers of their options or trying to prevent consumers from being coerced into a consent-to-rate situation.

Senator METZENBAUM. Let's assume a situation where buyer A goes to automobile dealer B who also happens to be a licensed insurance agent and also happens to have his own wholly-owned and controlled finance company. There is nothing to protect buyer A from being forced to buy a rated insurance policy from automobile dealer B, is there? He doesn't even have to take any burden of proof to say why he is putting him into a rated insurance premium?

Mr. NADEL. That was a problem, Mr. Chairman, that we did not specifically address in the study. We did not specifically ask that question or investigate that practice.

Senator METZENBAUM. Your report deals with availability. How many States collect or monitor the data on property and auto insurance necessary to determine the precise extent of availability problems?

Mr. HAVENS. Less than 20 percent of the States responding to our questionnaire reported that they collected any data, other than loss data on a geographic basis.

Senator METZENBAUM. How many States have carefully studied insurer practices within their borders to determine whether clean risks are able to get full coverage at standard rates? That ties in with my previous question.

Mr. HAVENS. None do so regularly. Virginia, however, did conduct a study which revealed relatively small numbers of clean risks in the assigned risk area.

Senator METZENBAUM. Looking at table 7, at page 42 of the Executive Summary,[1] I see that in several States young drivers with an ordinary compact car are being charged $2,000 to $2,500 for standard coverage. Does this mean that many young drivers, even with perfect records and excellent driving skills, have to pay rates like this?

Mr. HAVENS. Yes, sir, it does. One has to recognize, of course, that there are a number of characteristics which are assumed with respect to these numbers. We are talking about 18-year-olds commuting to

[1] The "Executive Summary" of the GAO report is on file with the subcommittee.

work. That sort of characteristic is built in but, yes, those rates are the ones quoted.

Senator METZENBAUM. The most disturbing part of your report in connection with this, I might say, is that my own State seems to ring the bell with the highest rate of $2,485, which is maybe indicative of the fact that the insurance industry has never been adequately regulated in my State, in my opinion, by reason of the fact that we always get insurance commissioners right out of the insurance industry. That is obiter dictum you need not comment on that. How many States ensure that consumers receive even minimal notice of the reasons their applications for insurance are rejected?

Mr. HAVENS. California, Wisconsin, and Virginia have such a requirement. There are, in addition, three other States: Massachusetts, North Carolina, and South Carolina which have mandatory offer requirements and that question simply wouldn't be relevant in those cases.

Senator METZENBAUM. Let's talk about the National Association of Insurance Commissioners. That is the National Organization of Insurance Commissioners?

Mr. HAVENS. Yes, sir, it is.

Senator METZENBAUM. They have meetings at various and sundry places, including some of the hot spots of the world?

Mr. HAVENS. I don't recall that we examined where they had their meetings, sir.

Senator METZENBAUM. How are the NAIC meetings funded?

Mr. HAVENS. They are funded primarily, perhaps entirely, through the fees paid by the insurance company representatives who attend the meetings.

Senator METZENBAUM. So that the entire cost of the trips, the meetings that are held, comes not from the States but comes from the funding provided by the insurance companies themselves?

Mr. HAVENS. Well, I was referring to the administrative costs of the meeting itself.

Senator METZENBAUM. Yes.

Mr. HAVENS. The travel expenses, I assume, would be paid by the State or by the individual.

Senator METZENBAUM. How are NAIC advisory committees staffed?

Mr. HAVENS. Largely by members of the insurance industry.

Senator METZENBAUM. Do consumer interests have any representatives on those committees?

Mr. HAVENS. In recent years, there has been some attention to the need for consumer representation. Until 1977, there apparently was no consumer representation. Today some advisory committees do have consumer representatives as members.

Senator METZENBAUM. To a limited degree?

Mr. HAVENS. To a limited degree.

Senator METZENBAUM. Your study concentrated on auto insurance. Our committee has interested itself in State regulation of industrial life insurance, as well. You did not get into that area at all?

Mr. HAVENS. No, sir, we did not.

Senator METZENBAUM. Did you examine cost disclosure in life insurance?

Mr. HAVENS. We looked at, very briefly, a study done by the Federal Trade Commission. We did not go behind that issue.

Senator METZENBAUM. Did you examine credit insurance?

Mr. HAVENS. No, sir.

Senator METZENBAUM. How many States have acted to assure that the average consumer can easily read his or her policy?

Mr. HAVENS. I believe Massachusetts has the most clearly established readability laws. However, I would point out that there are a number of individual firms which have undertaken readability efforts on their own, and have made significant strides in the direction of assuring readability of their policies in whatever State they are in.

Senator METZENBAUM. Not a State requirement, though?

Mr. HAVENS. But it is not a State requirement; I'm sorry, my staff corrects me—it appears that there are 11 States that do have readability laws of one variety or another.

Senator METZENBAUM. That would be 11 out of how many?

Mr. HAVENS. Yes, sir, 11 out of 46, out of the 51 jurisdictions; 11, based on a review of the State statutes.

Senator METZENBAUM. Mr. Havens, I think that Senator Thurmond may have some questions.

We appreciate your testimony, and I assume that if any members of the committee have written questions that they care to submit to you, you will be very willing to respond.

Mr. HAVENS. We will be pleased to do so.

Senator METZENBAUM. Mr. Nadel and Mr. Mendelowitz, is there anything that you care to add over and above that which Mr. Havens has said?

Mr. NADEL. Not I.

Mr. MENDELOWITZ. No, thank you.

Senator METZENBAUM. Do you think you would get fired if you did? [Laughter.]

Mr. HAVENS. They have never been reluctant to advise me of errors of omission or commission which I have committed in the past.

Senator METZENBAUM. Senator Thurmond, we are very happy to have you with us today. I have asked if you might have a number of questions which you wish to ask.

Senator THURMOND. Mr. Chairman, I ask unanimous consent that this statement follow your opening remarks.

Senator METZENBAUM. Without objection, it is so ordered.

Senator THURMOND. Mr. Chairman, I have just a few questions here.

Mr. Havens, on page 14 of your statement, if you will turn to that, the second paragraph there reads this way:

> Although there are variations in specific laws, resources and regulatory philosophies among the States, there is considerable consistency in the basic functions of the insurance departments found in every State and the District of Columbia. According to the NAIC, the basic functions undertaken by State insurance departments are as follows:
>
> 1. Licensing insurance companies and agents. The licensing function requires that a department enforce State law with regard to the formation of companies financial standards, qualifications as to character of management, and suspension or revocation of license.
> 2. Examining the financial condition and claims practices.
> 3. Implementing statutory standards. This entails making sure that rates are not excessive, inadequate, or unfairly discriminatory and that health policies meet standards requiring benefits to be reasonable in relation to premium.
> 4. Administering a complaint-handling office.
> 5. Enforcing unfair trade practices laws.

Now, the question that I have to propound to you is this: Is there a generally consistent manner in which most States administer the basic functions of insurance departments?

Mr. HAVENS. There is consistency in that the States do recognize fairly consistently that these are their responsibilities. I would say, however, that there is not consistency in the relative emphasis that various States place on various aspects of these responsibilities nor the resources applied to carrying out those responsibilities.

Senator THURMOND. Page 57, second paragraph, you state:

> Most the States we visited had a very positive philosophy of complaint-handling. They generally considered complaint-handling an important function and generally followed up on most complaints—at least to the point of getting some response from an insurance company.

The question is, do most States handle complaints in a similar manner? Is this handling, in your judgment, adequate and appropriate?

Mr. HAVENS. Well, I think it is a question of in terms of consistency, no. Some States have authority to require firms to respond in particular ways to a complaint when it is determined to be valid; most States, however, do not have that authority. In addition, most States, we found, did not maintain a systematic record of complaints of various sorts applicable to particular companies or analyze those complaints statistically to determine whether they were the pattern or practice of deception or other unfair trade practice which would be revealed by complaints. So, we did not find consistency, or what we would consider to be fully adequate handling of complaints.

Senator THURMOND. I might follow that up by asking you, has the consistency improved in recent years?

Mr. HAVENS. I have no basis of historical data on which to respond, Senator.

Senator THURMOND. On page 100 of your report the second paragraph, fourth sentence:

> Our own analysis leads us to concur with earlier studies that found that the automobile insurance industry is competitively structured and that price regulation is not warranted in the voluntary market. Moreover, price regulation does not result in insurance costs that are different from those in States without price regulation.

Would you care to comment on that?

Mr. HAVENS. Well, that is what we found. We concluded that the industry, from the standpoint of the structure of firms and degree of concentration in particular firms, was reasonably characterized as competitive. However, there are some significant elements necessary to effective competition which were inadequate. These relate primarily to consumer information about firms and, therefore, to the possibility of consumers choosing on the basis of informed judgment as to which firm was best equipped to handle that particular consumers needs, and, therefore, we felt that some action was desirable to strengthen and improve competition in the industry.

Senator THURMOND. Now, let's talk about going into plunging the Federal Government into the insurance business. The Supreme Court attempted that some years ago back in the thirties, as you know, when the McCarran-Ferguson Act was passed; it took away that authority so insurance is now within the responsibility of the States of the Nation. Do you understand that?

Mr. HAVENS. Yes, sir.

Senator THURMOND. I just wanted to remind you of the 10th amendment to the Constitution which reads this way: "Powers not delegated to the United States by the Constitution nor prohibited by it to the States, are reserved to the States, respectively or to the people." The word insurance is not even found in the Constitution that I know of, do you know whether the word "insurance" is found in the Constitution?

Mr. HAVENS. I am not aware of it being there, sir.

Senator THURMOND. I haven't found it there. Therefore, if this field has not been specifically delegated to the Federal Government under the Constitution, this field is reserved to the States; is it not?

Mr. HAVENS. I don't think I could carry the logic quite that far. I believe it would be fair to recognize that the insurance industry is interstate commerce and, therefore, if the Federal Government chose to, it could exercise regulation, I would presume, under the interstate commerce clause. But, I would want to make it clear that our report did not go to the issue of who should be responsible for improving the regulation of insurance. We examined the situation that we found, which was a situation of State regulation, and we found some deficiencies as one normally finds in examining any area of government activity. We did not take the next step of trying to explore what would be the most desirable means of correcting those deficiencies which we found. There are several options and, clearly, one of those options is correction by the States themselves.

Senator THURMOND. Suppose a State still had the responsibility, as they do now, and are exercising that responsibility. Did you read the statement of the insurance commissioner of New York who testified here sometime ago?

Mr. HAVENS. I have not personally read the statement.

Senator THURMOND. And the insurance commissioners all over the United States? They are opposed to the Federal Government entering this field and taking away from the jurisdiction of the States. The Governors of the States are opposed to it. Is it any wonder and reason why the Federal Government should inject itself into this place where it does not have authority? But, assuming it does have authority, I mean, assuming that the Federal Government does not have authority in this field and suppose the States were not administering insurance business in exact and proper ways. Would that be grounds for the Federal Government to intervene?

Mr. HAVENS. Senator, it seems to me that the judgment as to whether a problem is sufficiently severe to warrant intervention by the Federal Government is a judgment that, in the final analysis, must be made in political process. It is not something about which a GAO analysis can reveal ultimate truth as to the wisdom of Federal intervention or the failure to intervene. It is a question of tradeoffs between various objectives, one of which, obviously, is maximum discretion at the State level. But that is not the only tradeoff. We simply did not attempt to make that tradeoff in this report and I don't believe it would be appropriate for GAO to do so. We reported on the results that we found, and it is up to the Congress to decide whether further action is warranted at the Federal level.

Senator THURMOND. If there is any one State or more than one State that does not administer the insurance laws in the State properly,

does that warrant the Federal Government to enter the field or is it up to that State which has the authority to make the corrections?

Mr. HAVENS. In the first instance, it would be apparent to me that it would be up to the State itself to correct the problem. It would, however, not preclude Federal action if the problem were judged by the Federal political process to be sufficiently severe as to warrant Federal intervention.

Senator THURMOND. Do you believe that it appears then that if a State does not do its job right in the insurance or any other field, then the Federal Government can come in?

Mr. HAVENS. No, sir.

Senator THURMOND. Is that the theory?

Mr. HAVENS. That is not my theory. My theory is that if the political process of representative democracy concludes that a problem is sufficiently severe as to warrant solution at the Federal level, and I emphasize, if it judges the problem to be sufficiently severe, then, and presuming that the Constitution does permit Federal intervention, then that might be an appropriate option. But I come back to my original point that we did not come to that conclusion, we did not come to any conclusion as to who should be responsible for correcting problems.

Senator THURMOND. If in any one State, the State doesn't administer its highway department correctly, or if a number of States do not administer their road systems properly, is that sufficient grounds for the Federal Government to intervene and take charge and say, well, this State is not doing it right and maybe 10 States are not doing it right and maybe 30 States are not doing it right. Is that grounds then for the Federal Government to come in and take over? Or should the States themselves, should the people in the States do that correcting? And don't you think they will do it eventually? Congress has to correct many things here at the Federal level. Things are not always perfect. They are not perfect now. We are changing laws every year, but the States don't have the authority to come here and tell the Congress what to do, and neither does the Congress have the right to be telling the States what to do.

There are 51 sovereign governments in this country. There are 50 States and one Central Government, and this Constitution gave certain powers to the Central Government and it only has the power specifically given to it, and all other powers are reserved to the States.

Mr. HAVENS. Yes, sir, that is correct.

Senator THURMOND. On page 166 from your book, "Report to the Congress," I want to read several paragraphs here:

> Several arguments are advanced about the superiority of State versus potential Federal regulation. First is the virtue of federalism. As a noted insurance authority, Professor Spencer Kimball, has written:
>
> "The very basis of our Federal system is at issue, decentralization and dispersion of political power is in itself an important value in a democratic society. * * * Undue concentration of power in Washington is unwise from any power of view. Any problems that can be dealt with adequately at the State level should be handled there in preference to Washington."
>
> A second reason, cited by the NAIC, is simply that State regulation already exists, replete with experienced personnel, administering regulatory systems in all 50 States. Any Federal system, in contrast, would have to start from scratch and would result in the creation of a new Federal agency.

That is the very thing that we are trying to get away from now, so many Federal agencies, so many bureaucrats that are causing the people so much trouble. The people back home now are clamoring to me and I imagine every other Senator: "Get the Federal Government off my back."

Mr. HAVENS. Yes, sir.

Senator THURMOND. Have you heard that complaint?

Mr. HAVENS. I have heard that complaint; yes, sir. [Laughter.]

Senator THURMOND. The third argument for State regulation is:

That like federalism generally, the system promotes pluralism, experimentation, and vitality. The South Carolina Department of Insurance informed us that: "The (Insurance) Commission believes that one of the fundamental strengths of coordinated state regulation is its ability to find solutions to the various regulatory problems of the Insurance Industry with the efforts, talents, and initiatives of the 50 Insurance Departments of these United States. * * *"

Mr. Chairman, I ask unanimous consent that the rest of that page, 167 down to the heading "Analysis of the Advantages of State Regulation," be placed in the record.

Senator METZENBAUM. Without objection, it will be; and, without objection, the conclusion to be found on page 182 will also be included in the record at the request of the chairman.

[The remainder of page 167 follows:]

"* * * This approach not only recognizes that problems differ from State-to-State for economic, philosophical, social, and political reasons but also fosters flexibility and innovation in the development and application of regulatory techniques. It permits experimentation on a limited basis to find the answers to problems which may ultimately require a great degree of uniformity."

A fourth argument is that State regulation is more responsive to the public and to unique local needs. Thus, the Maryland Division of Insurance remarked that:

"The chief advantage of regulation by the states is that each state attunes its regulation to the locally prevailing conditions and requirements. The problems existing in one state may differ considerably from those in another part of the country."

Inherent in the argument, of course, is the assumption that many or most insurance regulatory issues do differ by State.

There is, finally, a somewhat perverse rationale for State regulation. An NAIC spokesman stated:

"An extremely important and unique advantage to State regulation is that the threat of a national alternative always hangs over it. State insurance regulatory agencies are subject to review, investigation and embarrassment by Congress which admittedly has the power to abolish the system if it so chooses. * * * Such congressional oversight no doubt stimulates State regulators to do a better job."

[The remainder of page 182 follows:]

While we found evidence for all the claimed advantages of State regulation, there were also cases where the advantages were not realized or where State regulation was counterproductive. In particular, the evidence is very mixed with regard to the purported greater responsiveness of State regulators to local needs. Many insurance problems are, in fact, not local problems. Even for local problems such as big city availability, many departments do not maintain the data necessary to address those problems. Most departments are also unable to respond to the special needs of the elderly with regard to supplemental health insurance. Only two of 17 departments were able to provide loss ratios, a rough measure of the value of policies, for health insurance policies aimed largely at the elderly.

While the so-called "revolving door" problem may be overstated by critics of State regulation, there still is less than an arms-length relationship between the National Association of Insurance Commissioners and the insurance industry. Although the situation has changed somewhat in the last year, there is still a substantial imbalance in the proceedings of the NAIC. There is almost no consumer participation, but almost no limit to the extent of industry participation.

Senator THURMOND. Thank you very much for your appearance.

Senator METZENBAUM. In order that the record may be complete, Senator, the ranking minority member has some questions on page 57 that will be included in the record.

[The questions of Senator Laxalt and responses of Mr. Havens can be found in the appendix.]

Several additional lines from the same report will be submitted to the reporter for inclusion in the record, and with respect to certain questions that were asked concerning page 100, additional language from the same report, also from pages 57, 100 and 101, will be included at the request of the chairman.

[The pages of the report referred to above follow:]

ISSUES AND NEEDED IMPROVEMENTS IN STATE REGULATION
OF THE INSURANCE BUSINESS
(Report of the Comptroller General to the Congress of the U.S.)
(Full report is on file with the subcommittee)

SUMMARY

Our limited review of financial examination revealed that improvements are needed in the resources devoted to financial regulation. In particular, there is a need for greater computer examination capability and for greater specialization among examiners. In reviewing some of the recommendations made 5 years ago by the McKinsey study, we find that very few of that study's recommendations have been adopted.

Most of the States we visited had a very positive philosophy of complaint handling. They generally considered complaint handling an important function and generally followed up on most complaints--at least to the point of getting some response from an insurance company. However, in most States we visited complaint handling was not a systematic part of trade practice surveillance. Although many States have the facility to utilize complaints systematically, few States appear to make complaint data a component of market conduct examinations. The market conduct examination is a particularly weak link in the process of company surveillance. There was no evidence in most States that there are implemented in the examination process itself qualitative standards of what constitutes unacceptable behavior by insurance companies.

In general, we find that State insurance departments, based on the 17 States we visited, do not utilize their personnel resources effectively in a systematic process of company surveillance. This is not to say that insurance companies in States with weak surveillance systems are neglecting consumers. Rather, the problem is that most insurance departments do not have adequate information on the nature and extent of existing problems. Without systematic information these insurance departments cannot regulate as effectively as they should.

While the market is competively structured, there still are market failures that may prevent the realization of a fully robust competition that would benefit consumers. Consumer knowledge is still a problem that requires regulatory intervention.

Consumers now have little or no information on which to judge the quality of insurance policies. State intervention should not be in the form of direct regulation, however. Rather, insurance departments can pursue the less intrusive strategy of collecting and disseminating (or requiring the dissemination) of information that would provide consumers with a better basis of knowledge in purchasing insurance. Such information might include annual price comparisons, by territory, for several widely purchased insurance coverages, complaint ratios (e.g., number of complaints per million dollars premium volume or per thousand policies), and requiring readable or standardized policy information prior to purchase so that consumers can compare policies. Additionally, consideration should be given as to whether regulations, such as permitting an extensive free underwriting period or prohibiting group automobile insurance, serve any purpose that justifies their potentially anticompetitive impact.

In summary, we believe that base insurance rates in the voluntary market need not be regulated if there is much greater regulatory action to inform consumers well enough to make the competitive market work beneficially and effectively. Our conclusion is based on our findings about aggregate rate levels. As we discuss in the next chapter, most insurance departments have not sufficiently analyzed classification and territorial plans. If it appears that rate differentials used by insurers to charge different premium prices to different areas and different categories of drivers are not warranted, then regulation of those differentials would be appropriate.

The concern over solvency that originally gave rise to rate regulation no longer justifies that kind of regulation; independent audits of the health of the industry would be adequate to ensure that insurance companies remain solvent and in a position to meet their claims.

[The prepared statement of Mr. Havens follows:]

PREPARED STATEMENT OF HARRY S. HAVENS

Mr. Chairman, we are pleased to be here to discuss GAO's study of the regulation of the insurance business by State insurance departments. In our study we reviewed the background, purposes, and need for insurance regulation; the resources and workloads of State insurance departments; and State insurance department surveillance of the financial condition and trade practices of insurance companies. We also conducted a more detailed analysis of the regulatory issues surrounding automobile insurance, such as risk classification, unfair discrimination, price regulation, and insurance availability.

Our study is based on data obtained from a questionnaire sent to all State insurance departments, fieldwork in the insurance departments of 17 States, and insurance industry sources.

This morning I would like to summarize our findings in four related areas:

The regulation of automobile insurance risk classification;
Insurance availability;
Trade practice regulation; and
The appropriate degree and extent of regulation of the price of automobile insurance.

RISK CLASSIFICATION

Personal risk classes

The price which a person pays for automobile insurance depends on age, sex, marital status, place of residence and other factors. This risk classification system produces widely differing prices for the same coverage for different people. Questions have been raised about the fairness of this system, and especially about its reliability as a predictor of risk for a particular individual. While we have not tried to judge the propriety of these groupings, and the resulting price differences, we believe that the questions about them warrant careful consideration by the State insurance departments.

In most States the authority to examine classification plans is based on the requirement that insurance rates be neither inadequate, excessive, nor unfairly discriminatory. The only criterion for approving classifications in most States is that the classifications be statistically justified—that is, that they reasonably reflect loss experience.

Relative rates with respect to age, sex, and marital status are based on the analysis of national data. A youthful male driver, for example, is charged twice as much as an older driver all over the country. None of the State insurance departments we visited conducts a regular independent actuarial analysis of these personal classification relativities to establish whether they are valid in its State. The State departments do not normally collect and analyze the information necessary to make these judgments on either a statewide basis or with respect to specific parts of their States. However, in two States which we visited, Massachusetts and New Jersey, the insurance departments undertook special comprehensive studies of the actuarial basis of classification plans. Massachusetts prohibited the use of age, sex, and marital status as rating factors, and New Jersey is still conducting a series of hearings on the issue.

Rates based on territory

Similar problems exist with the system of territorial rating. Different geographic areas have greater losses than other areas and insurers have established territorial rates to reflect these differences. For example, automobile insurance premiums are much higher in urban areas than in suburban and rural areas. However, higher losses in urban areas are the result, in part, of congestion caused by suburban commuters. The question has been raised as to whether it is fair to charge central city residents for losses caused (at least in part) by others. Furthermore, these territorial rating plans may also discriminate against minorities because urban areas usually have higher concentrations of minorities.

While insurance departments receive data on losses in each territory, most departments do not have sufficient information to evaluate whether or not the territorial boundaries used by insurance companies are fairly and accurately drawn. We reviewed whether the State insurance departments evaluate territorial rating plans to see if the plans satisfy their own statutory criterion that insurance rates are not unfairly discriminatory. Out of our 17 fieldwork States, 11 have not done so.

INSURANCE AVAILABILITY

Redlining: geographic discrimination

It has also been claimed that insurance companies engage in redlining—the arbitrary denial of insurance to everyone living in a particular neighborhood. Community groups and others have complained that State regulators have not been diligent in preventing redlining and other forms of improper discrimination that make insurance unavailable in certain areas. In addition to outright refusals to insure, geographic discrimination can include such practices as: selective placement of agents to reduce business in some areas, terminating agents and not renewing their book of business, pricing insurance at unaffordable levels, and instructing agents to avoid certain areas. We reviewed what the State insurance departments were doing in response to these problems.

We found that most States do not either systematically collect data or conduct special studies to determine if redlining exists. Only 36 percent of the States responding to our questionnaire reported that they had conducted studies of territorial discrimination over the past 5 years. While redlining is an issue primarily in urban areas, less than half of the urbanized States reported that they had conducted studies of alleged redlining.

To determine if redlining exists, it is necessary to collect data on a geographic basis. Such data should include current insurance policies, new policies being written, cancellations, and nonrenewals. It is also important to examine data on losses by neighborhoods within existing rating territories because marked discrepancies within territories would cast doubt on the validity of territorial boundaries. Yet, not even a fifth of the States collect anything other than loss data, and that data is gathered on a territory-wide basis.

Underwriting: a subjective practice

Underwriting practices also affect availability. While classification categories, such as territorial ratings, are based on explicit and objective categories, underwriting is more subjective, and may lead to consumers' being denied essential insurance because of unsubstantiated judgments. Questions have been raised about the propriety of certain underwriting guidelines. For example, some underwriting manuals list as "objectionable" such occupations as painter, automobile dealer, and waiter.

Only 26 percent of those responding to our questionnaire reported that they had the authority to forbid the use of particular guidelines. Few State departments even review or collect underwriting guidelines used by insurance companies. Generally, departments collect only some manuals or portions of manuals.

Furthermore, most States provide only limited protection to consumers who have had adverse underwriting decisions. Individuals who are rejected for standard automobile insurance can usually obtain insurance through assigned risk plans, but they often suffer adverse consequences such as limited coverage and higher prices. In about half the States for which we obtained rates, the cost of the assigned risk plan was at least 25 percent higher than the suggested rating bureau rate. In almost one-third of the States, consumers denied standard rate policies were purchasing insurance issued by the so-called substandard companies—whose rates were at least 20 percent higher than those of the assigned risk plans. We are not suggesting that these rates should be lower or higher. We do believe, however, that it is important for insurance departments to protect consumers against unwarranted denials of coverage, establish whether consumers are being unfairly discriminated against, and ensure that consumers are fully informed about these matters.

Most States do not require that consumers be informed as to why they were denied insurance coverage. Only three States out of 17 where we did fieldwork require insurance companies to provide the reasons for a rejection. Even in these cases, an explanation is required only if the individual makes a written request. Furthermore, none of the departments in which we did fieldwork knew why individuals are placed in assigned risk plans, although Virginia has recently participated in a study of the composition of the assigned risk plan.

Nearly all States protect consumers against arbitrary cancellation once a policy has been in force 60 days. However, 43 States allow a free underwriting period—usually 60 days—during which an insurance company can cancel a policy for any reason.

The protection provided policyholders by States is somewhat better with respect to cancellations and nonrenewals. Nearly all States require companies to give the reasons for cancellation. With respect to nonrenewal, however, only 15

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States require that the reasons accompany the notice. Fourteen States require that the reasons be given at the request of the insured. The remaining 21 States and the District of Columbia have no statutory requirement to explain a nonrenewal.

TRADE PRACTICE REGULATION: LACK OF SYSTEMATIC PROCEDURES

Risk classification and insurance availability were among several issues we reviewed where insurance departments lacked sufficient information to regulate effectively. While we did not examine all the data collection and analysis activities of State insurance departments, we found deficiencies in every one that we reviewed. There was also a lack of systematic procedures for handling consumer complaints and trade practice surveillance in most of the departments in our sample.

We examined whether insurance departments were responsive to consumer complaints, and whether departments were able to find out whether particular companies or trade practices were creating problems for consumers.

Most of the departments we visited followed up on consumer complaints, but have only limited authority to do anything about them. Most State insurance departments do not have systematic complaint handling procedures whereby complaints are coded, analyzed, and used in the examination and regulation of insurance companies. Complaints could reveal a pattern of abuses by insurers or agents, but such information is generally not developed.

Most insurance departments have been responsive to the recommendation of the National Association of Insurance Commissioners that, in addition to financial examinations, they should undertake market conduct examinations. Such examinations look at claims handling, advertising, underwriting, and other matters in order to identify insurers engaging in unfair business practices. However, based on the examination reports that we reviewed, the market conduct examination process needs considerable improvement.

For example, the National Association of Insurance Commissioners "Handbook for Examiners" recommends that examination results be compared to minimum qualitative standards to determine relative company performance. However, none of the market conduct examination reports we reviewed explained what the standards were or identified if such standards were used to assess company performance. Without set guidelines, it is impossible to tell whether actions by companies constitute a serious pattern of unfair practices or only an acceptable number of innocent mistakes.

The procedures used to monitor insurance company claims handling also need substantial improvement. None of the departments we visited monitors claims handling on a continuous or periodic basis other than in examinations—normally every 3 years. Moreover, these reviews only include the company's perspective and not the consumer's. The examinations in most cases showed no evidence of having contacted policyholders or complainants. Only one of the 17 fieldwork States, Wisconsin, regularly contacts a sample of policyholders and claimants as part of its examination process.

In short, the insurance regulatory process needs more and better information, and more systematic procedures, to assure that consumers receive adequate protection.

PRICE REGULATION OF AUTOMOBILE INSURANCE

Less regulation, however, may be a viable option with regard to the price of automobile insurance. In all States except Illinois, automobile insurance rates are subject to active or passive State regulation. The general requirement is that rates not be excessive, inadequate, or unfairly discriminatory. Approximately two-thirds of the States require prior approval of all changes in rates. The rest have a competitive rating system whereby insurers establish premiums without the need for prior approval.

We found great variety in the procedures and thoroughness with which the insurance departments review the rate filings of insurance companies. One common denominator, however, is that few States perform an original actuarial analysis of what rates should be. Rather, analysts review the calculations of insurance companies or rating bureaus. We found that in the two States, in our sample, that do their own original actuarial work, Texas and Massachusetts, the rates developed by the State staffs have proved, in retrospect, more accurate than those developed by the insurance company rating bureaus.

More fundamental than the procedures of rate regulation are the issues of the effects of price regulation and whether it is needed. On average, we found almost

no difference in automobile insurance cost between States that have prior approval price regulation and those that do not. It should be emphasized that these findings are stated in averages and are based on the relationship between premiums and claims payments for each State as a whole. Rate regulation in a few States has resulted in rates that are lower than they otherwise would be and the prohibition of certain rating factors in, for example, Massachusetts, has resulted in rates that are considerably lower for younger drivers.

Although there are imperfections in the market for automobile insurance, we believe that it may not be necessary for the government to regulate the base price of automobile insurance, except in assigned risk plans. As I noted earlier, however, differentials between various classes of risks, and the validity of the classifications themselves need greater attention by the States.

Regulation to enhance competition

In general we believe that consumers could be better served if insurance departments devoted fewer resources to price regulation and more resources to regulation designed to allow competitive forces to work more effectively. Although the automobile insurance market is competitively structured in terms of such indicators as number of firms, concentration ratios, and ease of entry, several factors nonetheless inhibit competition.

One major problem is that consumers simply do not have enough information to bring about as much competition as possible between insurers. While many insurance departments issue buyer's guides, very few compare specific premium rates for similar policies. The policies themselves are often written in obscure legal language and are difficult to understand. Only a few States require readable policies. And, by not widely disseminating information on claims handling and complaints against insurers, departments do not enable consumers to evaluate differences in quality among companies. The free underwriting period may also inhibit competition in that consumers may be hesitant to switch companies if they have no assurance against cancellation by the new company.

Insurance departments should do more to disseminate information about comparative insurance prices and indicators of the quality of companies. Such information might include price comparisons, by territory, for several widely purchased insurance coverages, insurance company loss and expense ratios, and easily understandable policy information. These measures would enable consumers to compare policies before purchasing insurance.

While we believe that competition can more efficiently achieve the lowest possible base prices, we also realize that regulation may be necessary to prevent the use of unfairly discriminatory rate differences.

BETTER REGULATION IS NEEDED

We have not attempted to conduct a comprehensive evaluation of all facets of insurance regulation. Based on the work we did, however, we conclude that a number of problems in insurance regulation need to be remedied. Many alternatives are available to that end: reform by the States themselves, a stand-by Federal role through the amendment of the McCarran-Ferguson Act that would allow regulation by Federal agencies in specific areas, the establishment of specific Federal standards through legislation, or the repeal of the McCarran-Ferguson Act and active Federal regulation. We hope our report will assist the Congress in evaluating these alternatives.

This concludes my prepared remarks. We will be happy to answer any questions.

Senator METZENBAUM [continuing]. The meeting stands adjourned.

[Whereupon, at 4:02 p.m., the hearing was adjourned.]

APPENDIX

United States Senate

COMMITTEE ON THE JUDICIARY
WASHINGTON, D.C. 20510

November 1, 1979

Dear Mr. Havens:

On October 9, 1979, you testified before the Subcommittee on Antitrust, Monopoly, and Business Rights in connection with the release of the General Accounting Office report entitled, Issues and Needed Improvements in State Regulation of the Insurance Business. You will find below a number of questions that deal with that report which I intend to include, along with your responses, in the hearing record for that day. In order to facilitate their inclusion, please send your responses as soon as possible to me with additional copies to the Subcommittee.

My first two questions deal in part with two corresponding quotes, one taken from the preliminary draft your office issued in June of this year, and the other quoted from the final version of the report named above. The relevant excerpts follow:

On pages 6 - 57 and 6 - 58 of the "Draft Report" issued in June of this year was the statement:

> "As long as it is national policy, manifested in the McCarran-Ferguson Act, that the States will regulate the business of insurance, the States are the appropriate arenas where the classification issue should be resolved. This is one area of insurance regulation that the people of each State should decide for that State the kind of policy they want." (Emphasis mine)
>
> "Because there are substantial economies of scale in studying the question of classification, there is an appropriate Federal role in studying or sponsoring studies of classification plans. Unless those studies show clearly and unambiguously that current classification plans are largely without merit and are unfairly discriminatory for substantial number

> of drivers, it appears appropriate that decisions on those classification plans continued (sic) to be left to the States." (Emphasis mine)

In the corresponding chapter in the final draft of the report on page 142, the GAO gives the following justification for a federal role:

> "Because there are substantial economies of scale in studying the question of classification, there is an appropriate Federal role in studying or sponsoring studies of the rise classification system. Indeed, since the State insurance departments have not yet examined the current classification plans with sufficient rigor to assure that they are not unfairly discriminatory, continued Federal consideration of risk classification is necessary. Inasmuch as the NAIC has declined to follow through on its task force finding and recommendations, uniform remedies to deficiencies in the current classification system will probably have to come through federal legislation." (Emphasis mine)

(1) The Comptroller General in his letter of introduction to the Executive Summary and the Final Report stated that "we (GAO) make no specific recommendation with respect to a Federal response to the cited shortcomings,...". Why is it that the portion of the final report (typed above) specifically recommends that the solution to the deficiencies in the current classification system will probably have to come through federal legislation"?

(2) In the draft of the proposed report there is a subsection entitled, There is no current need for Federal regulation. (Part of this section of Chapter Six is reproduced above.) While I understand perfectly that a proposed draft is subject to quality control and review before the final report is issued. I would like to know what it was in your review process that led to the 180 degree reversal so apparent when one compares the "draft" with the "final report"?

(3) It is my understanding that "market conduct evaluations", whereby consumer complaints are indexed, codified, and then analyzed, are a relative innovative concept insofar as they are applied to regulatory reform. Since the GAO went on at some length regarding the State's shortcomings in this regard, I would like to know whether it is the GAO's belief

that the States are not now attempting these processes or were the negative remarks occasioned because the States have not yet reached current federal standards in this area?

(4) The Digest to the final report begins ominously by stating that there are "serious shortcomings in State laws and regulatory activities...." Your testimony before the Subcommittee did not impart the same tone. Inasmuch as these were the first words of what was generally a balanced report, it is all the more important that it be understood in what sense the modifier "serious" was used. Are the shortcomings serious in the sense that the states have not demonstrated the same consumerist zeal evident in Federal regulatory agencies, or are the shortcomings serious in the sense that there appears to be a collective reluctance on the part of the State regulators to respond?

(5) In your report, you pass on the criticism that there exists a less than arms-length relationship between the NAIC and the insurance industry. I am left with the impression that there are unmentioned improprieties and instances of wrongdoing that were left out of the report. What facts do you have to support this inference?

I want to thank you in advance for taking the time necessary to respond to the questions posed above. Again, any expediting in this regard would be greatly appreciated.

Sincerely,

Paul Laxalt

PAUL LAXALT
U. S. Senator

PL/nsf

Mr. Harry S. Havens, Director
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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

PROGRAM ANALYSIS
DIVISION

DEC 7 1979

The Honorable Paul Laxalt
United States Senate

Dear Senator Laxalt:

I am writing in response to your letter of November 1, 1979, asking us to respond to several questions for the record of the Subcommittee on Antitrust, Monopoly, and Business Rights hearing at which we testified.

In preface to your questions one and two, you excerpted three paragraphs from our report, Issues and Needed Improvements in State Regulation of the Insurance Business, and two paragraphs from an earlier draft of that report. Before turning to your first two questions, it may be useful to clarify the nature of that earlier draft. As stated clearly on the cover of the draft, the document was a draft of a proposed report, was not fully reviewed, and was subject to revision. It is incorrect to characterize the draft as having been issued. Rather, it was circulated to the insurance departments in which we did field work for their review and comment.

We are sure that you share our concern about the unauthorized use of drafts of proposed GAO reports. Despite the clear admonition that recipients must not show or release the contents of drafts for purposes other than official review and comment, some reports, including this one, have been improperly released and circulated. Drafts are sent for official review in the interests of fairness and accuracy. Obviously if staff drafts are taken as official GAO reports, the utility of our review process is severely compromised. If the original recipients of the reports had acted properly, the resulting misunderstanding would have been avoided.

We are pleased to have the opportunity to provide the enclosed response to your specific questions.

Sincerely,

Harry S. Havens
Director

Enclosure

cc: Subcommittee on Antitrust,
Monopoly and Business Rights

Question 1

The Comptroller General in his letter of introduction to the Executive Summary and the full report stated that "we (GAO) make no specific recommendation with respect to a Federal response to the cited shortcomings,...." Why is it that the portion of the final report (typed above) specifically recommends that the solution to the deficiencies in the current classification system will probably have to come through Federal legislation?

Response

This comment in the GAO report was not a recommendation but an observation. We believe that there are deficiencies in the classification plans and if they were to be remedied uniformly in all the States, it is our judgment at this time that such uniformity is likely to be accomplished only through Federal action.

This judgment is based on a number of recent events. At its December 1978 meeting, the National Association of Insurance Commissioners (NAIC) deferred acting on its own task force recommendation that sex and marital status be banned as rating factors. Instead a resolution was passed exhorting the automobile insurance industry to "demonstrate concern and provide specific evidence thereof" with regard to "more equitable insurance pricing mechanisms." It was generally understood that action, originally expected in December 1978, was being deferred to June 1979.

However, in June 1979, the NAIC passed a resolution that only said, in effect, that classification systems should be proper. However, it is still unclear what resolution was actually passed by the NAIC. A statement purported to be the final resolution sent to us by a commissioner who is a member of the Automobile Insurance Subcommittee was substantially different from what the NAIC Central Office called the final resolution. The two versions are enclosed.

Based on this unsettled situation and inaction by the NAIC, we concluded that if uniform action were desired at this time, congressional action was the only probable route to such a policy.

Question 2

In the draft of the proposed report there is a subsection entitled, There is no current need for Federal regulation. (Part of this section of Chapter 6 is reproduced above.) While I understand perfectly that a proposed draft is subject to quality control and review before the final report is issued, I would like to know what it was in your review process that led to the 180 degree reversal so apparent when one compares the "draft" with the "final report?"

Response

Based on our analysis and complete review, we found that the States were not adequately addressing the classification issue. As noted in our response to Question 1, we judged that the NAIC is not likely to act in the near future. Therefore, we felt that it was appropriate to keep open the possibility that Federal action may be one way to address the problem.

Question 3

It is my understanding that "market conduct evaluations," whereby consumer complaints are indexed, codified, and then analyzed, are a relative innovative concept insofar as they are applied to regulatory reform. Since the GAO went on at some length regarding the State's shortcomings in this regard, I would like to know whether it is the GAO's belief that the States are not now attempting these processes or were the negative remarks occasioned because the States have not yet reached current Federal standards in this area?

Response

Market conduct examinations were proposed by the NAIC-sponsored McKinsey & Company study in 1974. Those we examined in 1978 all fell considerably short of the standards collectively suggested by the States themselves in the National Association of Insurance Commissioners Handbook for Examiners.

Question 4

The Digest to the final report begins ominously by stating that there are "serious shortcomings in State laws and regulatory activities..." Your testimony before the Subcommittee did not impart the same tone. Inasmuch as these were the first words of what was generally a balanced report, it is all the more important that it be understood in what sense the modifier "serious" was used. Are the shortcomings serious in the sense that the States have not demonstrated the same consumerist zeal evident in Federal regulatory agencies, or are the shortcomings serious in the sense that there appears to be a collective reluctance on the part of the State regulators to respond?

Response

The shortcomings are serious in that most departments do not collect the information necessary to discharge their own statutory mandates with respect to price discrimination, underwriting, claims handling, and other areas covered in our report. Collectively, our findings demonstrate very significant problems in protecting consumer interests. Therefore, we believe that the shortcomings should be characterized as "serious."

Question 5

In your report, you pass on the criticism that there exists a less than arms-length relationship between the NAIC and the insurance industry. I am left with the impression that there are unmentioned improprieties and instances of wrongdoing that were left out of the report. What facts do you have to support this inference?

Response

The problem that we refer to is not one of improprieties in the sense of particular unethical actions. Rather the issue is one of balance. As stated in the report (page 181):

> For the most part, the issue is not one of integrity, but judgment. Consumers do have some interests at odds with those of insurance companies and agents. Insurance industry officials may believe very sincerely that the programs they favor and the services they sell are already in the consumers' best interests. Nonetheless, there are other points of view

and other interests at stake. A regulator with an industry background may quite innocently retain the industry perspective--a perspective that is not always at odds with the interests of consumers but certainly is on occasion. All we state is that a regulatory system should seek balance between the need for firsthand expertise and for regulatory independence.

Final Resolution as sent by a member of the Automobile Insurance (D3) Subcommi

RESOLUTION ON AUTOMOBILE INSURANCE CLASSIFICATIONS

WHEREAS, the Rates and Rating Procedures Task Force of the Automobile Insurance (D3) Subcommittee presented recommendations at the December 1978 NAIC national meeting calling for the elimination of automobile insurance classifications based on sex or marital status characteristics; and

WHEREAS, consideration of these recommendations was postponed until the June 1979 NAIC meeting because of the concerns of several members about the effects of such classification changes on premiums for individual policyholders; and

WHEREAS, the advisory committee to the Automobile Insurance (D3) Subcommittee was directed to undertake an immediate study of alternative recommendations and implementation procedures, including the development of substitute classification variables; and

WHEREAS, the advisory committee has completed its study and has recommended that no action be taken by the NAIC regarding the elimination of sex and marital status classifications; and

WHEREAS, some individual automobile insurers, including Commercial Union Assurance and Motorists Mutual, are experimenting with alternative classification systems and are to be commended for their enlightened and innovative competitive vigor; and

WHEREAS, such experimentation demonstrates that the conclusion of the advisory committee is not universally accepted by all automobile insurers; and

WHEREAS, the two aforementioned insurance companies, as well as the states of North Carolina, Massachusetts and Hawaii, provide a readily accessible laboratory for experimentation; and

WHEREAS, the Rates and Rating Procedures Task Force does not accept the conclusions of the advisory committee, and believes that the information in the advisory report suggests the feasibility of developing alternative classification variables which would continue to provide effective rating classifications; and

WHEREAS, the task force further believes that the introduction of expanded use of these alternative classification variables will substantially reduce the effects of price changes which would otherwise be associated with the elimination of present classifications; and

WHEREAS, the insurance industry has consistently maintained that such changes should occur only through the process of competition; and

WHEREAS, regulation should rely wherever possible on effective competition to encourage meaningful experimentation and refinement of classification systems in order to attain greater pricing equity for consumers and more accurate risk assessment for insurers and to bring about differences in classification systems that inure to the benefit of consumers.

NOW, THEREFORE, BE IT RESOLVED, that the NAIC adopts the position that all rating classifications should be subject to minimum regulatory standards which require that rates and classifications for private passenger automobile insurance be based on a reasonable classification system, sound actuarial principles, and actual and credible loss statistics, relevant external data, or in the case of new coverages or classifications, reasonably anticipated loss experience;

BE IT FURTHER RESOLVED, that to encourage the pursuit of a more equitable automobile insurance pricing structure and the development of alternative rating factors which will contribute to meaningful competition and to more effective classification systems, the Rates and Rating Procedures Task Force be directed to continue study of these issues, and in doing so, to provide adequate opportunity for input from the Automobile Insurance (D3) Advisory Committee and other sources;

BE IT FINALLY RESOLVED that the NAIC calls on the industry to work with NAIC and participate in a program to monitor, evaluate and reassess traditional and experimental classification plans with particular emphasis on the impact of sex and marital status as rating criteria. Such program is to be developed and implemented as follows:

1) The Rates and Rating Procedures Task Force of the Automobile Insurance (D3) Subcommittee with the assistance of other NAIC members and the NAIC Central Office is to develop a theoretical model classification plan designed to include alternatives to sex and marital status as rating factors.

2) Following development of such model, the Rates and Rating Procedures Task Force will specify the statistical data and other informational requirements necessary to pilot test the program;

3) The Insurance Services Office and/or other statistical agencies will be called on to assist NAIC in accumulating and compiling the necessary information received from the participating insurers and will assist the NAIC in analyzing and evaluating such information.

4) The model classification plan is to be developed on or before September 1, 1979, by the Rates and Rating Procedures Task Force.

5) The statistical agencies are to be advised of the informational requirements by the Rates and Rating Procedures Task Force and such requirements are to be transmitted to the participating insurers on or before December 1, 1979.

6) An interim report on the status of the pilot test program is to be presented to the Automobile Insurance (D3) Subcommittee by the Rates and Rating Procedures Task Force

at the December 1979 meeting with subsequent progress reports at each following regular and annual meeting of the NAIC until conclusion of the program.

7) The pilot test program shall be completed and a final report shall be presented to the NAIC at its June 1981 meeting.

Final Resolution as sent by NAIC Central Office

SUBSTITUTE RESOLUTION ON AUTOMOBILE INSURANCE CLASSIFICATIONS

WHEREAS, the Rates and Rating Procedures Task Force of the Automobile Insurance (D3) Subcommittee presented recommendations at the December 1978 NAIC national meeting calling for the elimination of automobile insurance classifications based on sex or marital status characteristics, and

WHEREAS, consideration of these recommendations was postponed until the June 1979 NAIC meeting because of the concerns of several members about the effects of such classification changes on premiums for individual policyholders; and

WHEREAS, the advisory committee to the Automobile Insurance (D3) Subcommittee was directed to undertake an immediate study of alternative recommendations and implementation procedures, including the development of substitute classification variables; and

WHEREAS, the advisory committee has completed its study and has recommended that no action be taken by the NAIC regarding the elimination of sex and marital status classifications; and

WHEREAS, some individual automobile insurers including Commercial Union Assurance and Motorists Mutual, are experimenting with alternative classification systems and are to be commended for their enlightened and innovative competitive vigor; and

WHEREAS, such experimentation demonstrates that the conclusion of the advisory committee is not universally accepted by all automobile insurers; and

WHEREAS, the two aforementioned insurance companies, as well as the states of North Carolina, Massachusetts and Hawaii, provide a readily accessible laboratory for experimentation; and

WHEREAS, the Rates and Rating Procedures Task Force does not accept the conclusions of the advisory committee, and believes that the information in the advisory report suggests the feasibility of developing alternative classification variables which would continue to provide effective rating classifications; and

WHEREAS, the task force further believes that the introduction of expanded use of these alternative classification variables will substantially reduce the effects of price changes which would otherwise be associated with the elimination of present classifications; and

WHEREAS, the insurance industry has consistently maintained that such changes should occur only through the process of competition; and

WHEREAS, the regulation should rely wherever possible on effective competition to encourage meaningful experimentation and refinement of classification systems in order to attain greater pricing equity for consumers and more accurate risk assessment for insurers to bring about differences in classification systems that inure to the benefit of consumers;

NOW, THEREFORE, BE IT RESOLVED, that the NAIC adopts the position that all rating classifications should be subject to minimum regulatory standards which require that rates and classifications for private passenger automobile insurance be based on a reasonable classification system, sound actuarial principles, and actual and credible loss statistics, relevant external data, or in the case of new coverages or classifications, reasonably anticipated loss experience.

○