JOHN GARAMENDI
Insurance Commissioner

March 29, 2004

The Honorable Michael G. Oxley
Chairman, House Committee on Financial Services
2308 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Oxley:

After considering the specifics of your latest proposal on federal and state insurance regulation, I am writing to express some major concerns about the direction you are exploring. I will not be able to attend the hearings in Washington D.C. and although I agree with some of the positions expressed by my colleagues at the NAIC, I think California has a specific story to tell that should be considered in your deliberations. For this reason I have taken this opportunity to put my thoughts in writing for your consideration.

I urge you and your colleagues to consider the significant benefits state based insurance regulation brings to consumers before you undertake the changes to the system that you outlined at your NAIC presentation in March.

In that presentation, you proposed a series of changes to the system of state-based regulation that has governed insurance for 135 years. I am concerned that under your proposal insurance would become a largely unregulated business, in which states are bound by federal decisions that could unduly restrict public scrutiny and appropriate regulation of insurance business practices.

Under the plan you have proposed:

1. A federally-appointed national insurance coordinator would oversee a Federal-State advisory council that would take responsibility for a new federal insurance system.

2. The insurance rate regulation systems that exist in about half of the states would be scrapped for a deregulation of insurance rates.

3. State-based enforcement of consumer protection laws would be replaced with a system that would unduly restrict a state official from determining when and how to initiate market conduct exams.

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4. Individual state insurance departments would no longer oversee the licensing of insurance companies or the review of new types of insurance policies.

Contrary to your stated rationale for this legislation, I believe that insurance products are sufficiently dissimilar to all other financial products and other non-monopoly services that they should be subject to higher scrutiny, and may require more and different regulatory oversight. Such oversight, I believe, is appropriately developed and implemented at a more local level. I also believe that the states are capable of and are making good progress towards appropriately addressing legitimate concerns that industry representatives have raised with regard to fair treatment, efficiency, and some standardization.

Unlike most other consumer products insurance is mandatory for legal reasons and because of the dictates of commerce. Historically, states have held a higher standard for for regulating goods and services that are essential. Because state legislators make so many decisions about which products are mandatory and what benefits are required by particular policies, it makes sense that the state regulator is in the best situation to implement these state policies.

Consumer complaints that allow scrutiny of patterns of practice that are unfair to consumers and appropriately drive market conduct review, can only be achieved at the local level. Although this area is challenging for states, you need only to consider the abysmal record of the FERC and the FCC to realize how effective the states are. Even if consumer complaints continue to be handled at the local level, it is imperative that the rest of the regulatory apparatus be locally controlled so that it can effectively integrate knowledge about local practices into effective oversight. Underwriting and rating are driven by judgment that will not be universally equitable. Local regulators are more suited to evaluate these practices. Additionally, insurance differs from other products in a variety of ways related to the nature of an insurance policy. Complex policy provisions and long tails make a remote and under-resourced regulator ineffective.

Federalizing and Deregulating Insurance Would Be Costly and Dangerous for America's Consumers

1. Under the proposal a federally-appointed national insurance coordinator would oversee a Federal-State advisory council that would take responsibility for a new federal insurance system.

We do not believe that the federal government or some quasi-national body should take over the regulation of insurance for the country. Although the idea is not completely formed it is potentially unworkable. I fear that lack of clear authority and squabbles over legitimate jurisdictional issues will undermine the potential of such an advisory council. I also believe that the federal government representatives currently have full access to all state regulators through the NAIC. The proposed advisory group seems duplicative of the functions that the NAIC is well suited to perform. It would be a mistake to bypass the institutional wisdom and depth of knowledge within the NAIC by creating a new entity at this juncture.

2. Under the proposal the insurance rate regulation systems that exist in about half of the states would be scrapped for a deregulation of insurance rates.

This proposal aggressively attacks insurance rate regulation, chiefly targeting the prior approval system of insurance regulation, such as that in California. You point to the "travesty of price controls" and argue that "States with free-market competition among insurers have consistently achieved more choices and better prices for consumers in the long term than States that ...[impose] price controls on the marketplace." In particular, you highlight the state of Illinois as the model for a national deregulation effort.

The data tell an entirely different story. During the 1980s, California operated in an Illinois-style market and premiums had been pushed to an astronomically high level. Responding to the failure of the unregulated market, voters in the state enacted a system of prior approval regulation through Proposition 103 in 1988. Under California Proposition 103, insurers must justify rate changes to the Commissioner prior to implementing them. In addition, any California consumer may request a hearing and challenge rates. Since that change, auto insurance premiums have declined in California, while premiums have increased nationwide. The Illinois market has seen increases that outpace the national average. According to NAIC data for average auto insurance premiums by state:

	California	Illinois	USA
1989	$748	$505	$551
2001	$689	$682	$718
% Change	-7.9%	+35.0%	+30.3%

(Total Written Premium/Liability-Car Years)

Over the past 15 years, California's insurance system has been the nation's success story in terms of policyholder protection. According to the Consumer Federation of America study *Why Not The Best*, Proposition 103 has saved auto insurance consumers in California over $23 billion.

Not only has California seen the most substantial consumer benefits since regulation was installed by the voters, it has been above average in profitability for insurers as well. In fact, over the past decade California has been more profitable than Illinois in every major line of insurance with the exception of workers compensation, which was deregulated in California in 1993.

3. State-based enforcement of consumer protection laws would be replaced with a system in which states had to depend on either the market conduct exams of insurance companies conducted by other states or the self-certification of an insurance executive that an insurers' behavior and practices were appropriate.

As you are aware, I am not a fan of the NCOIL market conduct approach. Pre-empting the NAIC and states' rights to determine the appropriateness of coordinating examination of insurer behavior is another attempt to deregulate the system and leave the public less protected by removing the tools that strong regulators have to enforce best practices.

The plan would require regulators to dramatically reduce the individualized evaluation of market behavior by insurance companies and instead depend on CEO certification that insurer conduct is up to snuff. It would be a grave mistake to turn the examination of insurance company practices over to the executives who run insurance companies.

To the extent that actual regulatory exams take place, the proposal would mandate that all states accept the exam performed by any state, thus denying states the ability to investigate companies' behavior in light of their own consumer protection and financial solvency statutes. This would require a federalizing of investigations. As we discussed above, state regulators are in the best position to protect consumers from improper insurance practices. This is not only because of the local nature of insurance policies, but because a regulator with a smaller jurisdiction (a state as opposed to the nation) can more effectively identify problems and intercede to stop dangerous and improper practices.

4. State insurance departments would no longer oversee the licensing of insurance companies or the review of new types of insurance policies.

The proposal asserts that state-by-state oversight of different types of insurance policies delays insurers that want to quickly get new policies into the marketplace. The presentation indicates that insurance companies should be able to sell policies without the thorough review that occurs under regulation. This proposal suppresses differences among states and fails to acknowledge that the first priority of each state commissioner is to protect the consumers of their state, not to remove obstacles for insurance companies.

I believe the large states' efforts to establish shared standards for policy approval will be a significant change in the way policies are currently approved. It has great potential to speed products to market and give some clear guidelines to the industry. Significantly, the states involved are coalescing around the highest standards of consumer protection. This is important. We do not want standardization to be a race to the bottom. Carriers can meet fair standards as long as they know what to expect. I am very much in favor of giving them clear and uniform standards, as long as they are the best standards for consumers.

American Consumers Need More Protection, Not Less, From High Insurance Premiums and Unfair Insurance Industry Practices

In your presentation to commissioners you argued that the insurance industry is not profitable enough and that the proposal to federalize and deregulate insurance would address problems in the insurance industry.

I disagree with this view and the plan that you have set forth. I do not believe that a radical reduction of oversight of insurance companies is in the best interest of American consumers, taxpayers or the economy generally. We should not forget the colossal damage done as a result of the recent spate of corporate scandals in financial and other large industries subject to the type of weak federal regulatory scrutiny that the plan envisions for the insurance industry.

In my view the combined effect of this proposal would be to destabilize the insurance marketplace and undermine a legacy of insurance laws developed by the states over the course of the past 135 years of state-based insurance regulation. But the most severely negative impact of this proposition is reserved for American consumers, who would inevitably face higher premiums and less protection from fraud and other unfair insurance practices.

True reform will require the expansion of regulatory oversight through strong state initiative and coordination. The states can address legitimate concerns the industry expresses about modernizing regulation. They can do it while preserving the quality and fairness of the claims process, and providing affordable insurance to the millions of American consumers and business who represent the policyholders that we serve. I am afraid the federal government is not up to the task. It will not invest enough resources in the process, and federal regulators are too remote from the problems the states deal with more effectively.

I like forward to working on initiatives that will address legitimate concerns about regulatory modernization, without doing a disservice to consumers.

Sincerely,

JOHN GARAMENDI
Insurance Commissioner

JG:gc/vov

cc: Members, House Committee on Financial Services
Members, National Association of Insurance Commissioners