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August 12, 2005

Division of Insurance
HCR 83 Working Group Chair, J.P. Schmidt
335 Merchant Street, Room 213
Honolulu, HI 96813

Sent by Facsimile
808.586.2806

RE: HCR 83, NCOIL PROPERTY-CASUALTY INSURANCE MODERNIZATION ACT

Dear Chairperson Schmidt:

Thank you for affording the National Association of Mututal Insurance Companies (NAMIC) an opportunity to submit written comments to the legislative working group empowered to review the NCOIL Property-Casualty Insurance Modernization Act.

NAMIC is a full-service national trade association with more than 1,400 member companies that underwrite 43 percent ($196 billion) of the property/casualty insurance premium in the United States. NAMIC membership includes four of the seven largest property/casualty insurance carriers, and every size regional and national property/casualty insurer, including hundreds of farm mutual insurance companies.

NAMIC's number one public policy priority is to assist state legislatures in their efforts to evaluate and implement a reformed system of state regulation of insurance through the passage of regulatory "modernization" laws. The elements of a "modernized" system of state regulation include: a use-and-file system for personal lines rate approval; a no-file system for commercial lines; continued regulator authority to monitor market competition; and administrative due process for consumers and the insurance industry. NAMIC is also a strong proponent of reformed market conduct and financial solvency regulation to protect the interests of consumers and policyholders. Our ultimate goal is to achieve a regulatory system that promotes a highly competitive marketplace, where consumers are provided with a wealth of options in regard to insurance carriers, insurance products, and insurance rates. To that end, we are working in partnership with the National Conference of Insurance Legislators (NCOIL), the National Conference of State Legislators (NCSL) and our other industry colleagues to secure passage of regulatory "modernization" laws in as many states as possible.

We believe the primary barrier to fundamental reform of the property/casualty industry is price regulation of insurance rates. This belief is the cornerstone of NAMIC's agenda for change in the states.

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Passage of rate modernization laws, benefit the insurance industry, the business community and the insurance consumers in the following ways:

1) Promotes greater market competition in the insurance industry: The United States economy is founded upon the premise that free-market competition is fundamental to capitalism and that government regulations in the marketplace should be designed to *promote* open and effective market competition for the benefit of the consumer. Unfortunately, many states, with the intent of protecting consumers, have used government regulations to *restrict* open and effective market competition.

Insurance is an industry where less government control has been tested and found to be successful. For example, in 1969, the State of Illinois moved away from "prior approval" in favor of a competition-based system for personal lines of insurance, a system that is still in effect today. Several signs demonstrate this system has works well and benefits insurance consumers: a) Illinois consumers enjoy stable rates, ranking in the middle of all states in average expenditures for insurance; b) Illinois has a relatively small residual market indicating affordability and availability of insurance products; and c) There are over 200 insurance companies domiciled in Illinois and more than 500 insurance carriers who write auto insurance in the state. Without a doubt, the open competition rating law has worked successfully for Illinois consumers.

As a second example, consider the State of South Carolina. In 1996 only 78 insurers offered auto insurance policies in the state and 40 percent of all insured drivers were in the assigned risk pool. With the elimination of prior approval in 1999, 105 new companies have entered the marketplace. In contrast, a review of the marketplace in Massachusetts, a very restrictive regulatory state, demonstrates that a restrictive regulatory system quells market competition. According to Massachusetts state law, the insurance commissioner in Massachusetts mandates set rates that must be utilized by all insurers, with only limited deviations being permitted. This over-regulation in the state has driven insurers out of the market, reduced the number of insurance products available to the consumer and has caused unprecedented growth in the residual market. Evidence of Massachusetts' regulatory failure is clear when one considers the fact that Massachusetts has one of the lowest number of domiciled insurance companies in the nation. Moreover, the number of licensed auto insurers is 40-50% percent lower than the average number of auto carriers doing business in other states throughout the nation.

2) Streamlines rate filing with the Division of Insurance: States that have a restrictive regulatory system, like "prior approval", are generally plagued by laborious administrative processes that: a) delay the implementation of changes in insurance rates; b) discourage insurance carriers from offering new insurance products; c) create unnecessary administrative expenses for insurance carriers, which adversely impacts the cost of insurance to the consumer, and/or the quantity and quality of services available to the consumer; and d) result in the expenditure of limited state resources on agency procedures that are neither necessary nor appropriate mechanisms for protecting

insurance consumers. Further, these lengthy and convoluted administrative procedures frequently lead to protracted and expensive administrative appeals and civil litigation.

Moreover, restrictive regulatory systems create a political dynamic that is susceptible to political manipulation and grandstanding. Consequently, consumers are often the ones who end up paying for a political "showdown" between regulators and legislators that want to use the emotional fervor associated with insurance regulations as a vehicle to disseminate their personal political ideologies. One need only look at the state of California for proof of the fact that a restrictive regulatory system is rife with potential for misuse as a medium for promoting a politician's long term political aspirations.

3) Increases insurance product availability and typically reduces insurance rates: Studies have routinely demonstrated that rate modernization increases availability of insurance products and typically results in premium savings to the insurance consumer. This point is best illustrated by the comments made by the Louisiana Commissioner of Insurance, J. Robert Wooley, who stated that "information provided to a joint meeting of the Louisiana Senate and House Insurance Committees today [March 2005] shows the positive results of flexible insurance rating, including more than $38 million in savings in the form of rate decreases for consumers." Further, since implementation of rate modernization in Louisiana, 14 new insurance carriers have entered the Homeowners' Insurance market in the state and the prospect for further market competition has been improved.

4) Reduces the incentive for the federal government to preempt state insurance legislation: Over the past three years, 12 states have adopted some form of regulatory modernization. In 2003, modernizing legislation was adopted in Nebraska (commercial lines), New Hampshire (commercial lines), New Jersey (auto), Louisiana (personal lines) and Texas (personal lines). In 2004, modernizing legislation was adopted in Massachusetts (commercial lines), Oklahoma (personal lines), Rhode Island (personal lines), South Carolina (homeowners), and South Dakota (personal and commercial lines). In 2005, modernizing legislation was adopted in Alaska (personal lines), Minnesota (personal lines), and Nebraska extended their reform efforts to personal lines. This pattern of rate modernization clearly demonstrates that there is an ever growing belief that the restrictive regulatory practices of the past have not prompted insurance rate reductions, as hoped by those promoting restrictive regulatory practices, and that regulation of the insurance industry must be approached from a market competition standpoint, like the one that is controlling in the other professional sectors of the business community.

If states continue to resist the national trend toward rate modernization, the federal government may be forced to intervene and preempt state insurance legislation so as to promote open-market competition. By adopting rate modernization at the state level, the impetus for the adoption of a Federal Insurance Charter is less potent and states are more likely to be able to retain control over their local insurance marketplace.

5) Indirectly improves the efficiency and accuracy of insurance underwriting and claims adjusting: According to a 2001 study conducted by the Center for Risk Management and Insurance Research at Georgia State University on the impact of restrictive regulatory systems, like the one that used to exist in Georgia,

> constraints on pricing and underwriting caused several problems. It limited insurers' flexibility in tailoring their pricing structures so that they might charge premiums corresponding to a driver's relative risk and expected losses. In practice, this tended to prevent insurers from charging adequate rates to higher-risk drivers. This contributed to the state's large residual market, despite a mandatory service, i.e. "take-allcomers", requirement. It also diminished incentives for higher-risk insureds to improve their safety and, hence, would be expected to contribute to higher loss costs and exacerbate market and political pressures."[1]

In other words, the policies and procedures associated with a restrictive regulatory system, directly impact the risk management decisions of insurance consumers, the claims practices of insureds and the relationship between the insurance industry, the state regulator and the judicial system.

As the authors of *Auto Insurance Reform: The South Carolina Story*, opined during their analysis of the impact a restrictive regulatory system can have on the insurance industry,

> [T]ight restrictions on price levels and price structure, regardless of their motivation, tend to distort market incentives. This can contribute to rising loss costs that pressure rates to rise and intensify conflicts between regulators and insurers. Constraints on risk-based pricing also tend to create inequities among groups of insureds and contribute to adverse selection. The residual market interacts with these forces and can suffer rapid growth and large deficits, depending on how it is structured and regulated. Insurers and/or insureds will ultimately bear the burden of subsidies of the residual market. To the extent that there are negative effects on insurers, they will be less inclined to enter the market and more inclined to leave it. This diminishes consumer choice among different insurers. [2]

In conclusion, NAMIC applauds the Hawaii Legislature's decision to explore the idea of joining the ranks of states that have adopted some form of rate modernization as a pragmatic mechanism to stabilize and regulate insurance rates, promote responsible insurance practices, and break the perpetual and escalating cycle of regulatory action that has distorted the insurance marketplace to the detriment of the insurance consumer.

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[1] Matrin F. Grace, Robert W. Klein, and Richard W. Phillips, *Auto Insurance Reform: The South Carolina Story,* Center for Risk Management and Insurance Research, Georgia State University, 11 (2001).
[2] *Id.* at 54-55.

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Thank you for affording NAMIC an opportunity to share its thoughts on rate modernization. If NAMIC may be of further assistance to the HCR 83 working group, please do not hesitate to contact me at (970) 204-6695 or by email at crataj@namic.org.

Sincerely,

Christian John Rataj, Esq.
State Affairs Manager-Western Region