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Who'll Watch The Insurers?

The Industry and Its Many Overseers Enter Battle Over Regulatory Reform

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State insurance regulators from around the nation "are now fully prepared to go before their various legislative committees with recommendations for a system of insurance law which shall be the same in all states," the head of the National Association of Insurance Commissioners said confidently in 1871.

"We can deliver before 2008," another NAIC leader told a House subcommittee last month.

Americans who move from place to place learn -- sometimes to their delight, other times to their horror -- that insurance is a quirky affair, regulated differently by each state. The auto insurance required in one jurisdiction, for instance, may fit right into the family budget, while in another it might mean no pizza or movies for a month.

This has been the American system, especially since 1945, when Congress formally handed over the authority via the McCarran-Ferguson Act. Since then it has been an article of faith in the insurance industry that state regulation is the most desirable system.

But now many in the industry say it's time for fundamental change -- and these voices are being heard on Capitol Hill. Reaching basic agreement on a new structure certainly hasn't become any less complicated in the past 133 years, nor is there agreement on what such a basic change might mean for consumers.

The current system, according to critics, stifles competition and builds in inefficiency and high cost. Reform, they say, would give consumers greater choice and better prices on insurance products.

Consumer groups agree that reform could be beneficial. At the same time, though, they worry about the details, concerned that change could lead to significant weakening of controls so that Americans would be left with soaring premium costs, abusive sales practices and unjustified insurance cancellations.

At the moment, Congress is studying whether to step in. The Supreme Court long ago ruled -- in the case that prompted enactment of McCarran-Ferguson -- that insurance is interstate commerce and subject to federal authority. But exactly how much authority Washington should exert is proving to be no easy decision.

What Congress eventually decides is of major importance to both industry and consumers. Huge amounts of money are at stake. Insurance premiums in 2002, the most recent data available, totaled more than \$885 billion -- \$508 billion for life and health insurance and \$377 billion for property.

"There are three camps right now," said Robert A. Rusbuldt, head of the Independent Insurance Agents & Brokers of America, a trade group known as the

Big I. Some want the option of federal regulation, some want the status quo, and some want to reform the state system by putting federal pressure on state legislatures, he said. "That's a middle ground . . . and that's where we are."

The prospect of federal intervention in some form has touched off a classic Washington-style round of elbowing and jockeying for position as industry players try to shape the debate to favor their interests. Even to refer to insurance as one industry is slightly misleading. Each component has its own set of concerns and priorities. For example, automobile and homeowner insurers are pressing for something that will curtail or eliminate state regulation of the prices they charge. Writers of life insurance have a different set of issues.

The insurance bloc breaks down even further in the matter of size -- the enormous firms that operate nationwide and the small outfits with a local or regional focus.

Many life insurers and big property-casualty companies have endorsed what they call an optional federal charter. This would be a system resembling bank regulation in which companies would have the option of being regulated by Washington or the states.

This prospect frightens small companies, particular among property insurers. If they do business in their home state, guided by state regulations, they might well be competing against large national players who get to play by looser federal rules. The small companies want to preserve the states' sway over insurance, though they agree local systems could be made more efficient and less cumbersome. This position is supported by the National Association of Insurance Commissioners, who are of course the state regulators whose future is at issue here.

The capital markets and insurance subcommittee of the House Financial Services Committee has held 15 hearings over the past three years on the subject. Last month Michael G. Oxley (R-Ohio), chairman of the full committee, rejected pure federal regulation, dual regulation and an optional federal charter. Instead, he said in a speech to the NAIC, he favors a hybrid system in which states would continue to be primary regulators but with "a federal-state partnership to coordinate our insurance policies and uniformity."

Oxley's "road map" was quickly endorsed in principle by most in the industry -- not surprisingly, since in principle at least it promises to give the NAIC, insurance agents and carriers what they want. It promises continued regulation by the states, which the NAIC wants; more uniform and streamlined licensing for agents, which they want; more efficient approval of new products; an end to repetitious state investigations of company behavior, which life insurers particularly want; and an end to what Oxley called "the travesty of price controls" imposed by states, which the property insurers want.

An Oxley aide said the process of writing a bill is just beginning, and its exact form is far from set.

Whatever emerges is certain to be controversial. Many insurers don't see how Oxley's plan can deliver what it promises -- while consumer groups worry that it just might do that.

J. Robert Hunter, director of insurance for the Consumer Federation of America, told the capital markets subcommittee that the road map sacrifices consumer protections in the name of efficiency. He told the panel that fear of federal regulation has already led many states to deregulate commercial insurance. "In the rush to head off federal intervention, [such states] have left very small businesses, which are frequently not sophisticated buyers of insurance, exposed to abuse," he said.

Key pressure for a large federal role is coming from life insurers and large property carriers, which operate in most or all states. Such carriers have concluded that dealing with one national regulator would be a lot simpler and easier than 50-plus state-level ones. These big carriers have also watched banks with envy since the 1990s. That's when Congress allowed the banks to offer additional financial services, allowing them to push new products to market in a matter of weeks while state regulators took months or years to approve insurers' offerings.

Those in favor of the federal option have derided state regulators, pointing to petty bureaucratic requirements that go to the color of paper insurers must use in submitting materials for approval, and whether staples are required or forbidden.

"We know we have some problems in this regulatory system," NAIC President and South Carolina Director of Insurance Ernst Csiszar acknowledged to the capital markets subcommittee last month. But he said an optional federal charter would be "the worst of all worlds."

Such an option, he and others fear, would allow companies to play off state and federal regulators against one another, touching off a race to the bottom as regulators seek to keep companies from jumping back and forth to whichever standard is more lenient.

NAIC officials argue that the states are working vigorously to clean up their inefficiencies. And as they do, said New York Insurance Superintendent Gregory V. Serio, they can turn their attention away from worrying about forms and rates and "recast resources" to consumer protection and checking companies' financial soundness.

That seems to alarm some segments of the industry. Whereas once state regulation was often a cozy arrangement in which commissioners came from the industry and went back to it, a disincentive for doing anything the industry would call unreasonable, politicians have found in recent years that being a tough insurance regulator can be a steppingstone to higher office. Congress is now sprinkled with former insurance commissioners, and others have sought and sometimes won top state offices.

The debate takes place against a background of periodic spikes in rates in many states, particularly for automobile insurance but also for workers' compensation and homeowner insurance.

The NAIC and consumer groups agree that many property hazards are local -- mold in Texas, earthquakes in California, hail in the South and Midwest, for example -- and state regulators are better equipped to supervise those coverages.

But consumer groups worry that if rate regulation and other controls are overridden by the federal government, policyholders will suffer, especially if there is some kind of crisis as there was in Florida after Hurricane Andrew in 1992. Following that storm, insurers sought wholesale rate increases, and many tried to withdraw from the state -- but state regulators blocked them.

The consumer groups also worry about how such other issues as red-lining and use of credit scores underwriting would be handled.

Life insurers say their main focus in the debate is on the difficulty they have in getting new products onto the market. They note that banks and other financial services companies can move much more quickly, and they would like to be able to compete on the same footing.

"The days of life insurance companies competing only against other life insurance companies are long gone," said Gary Hughes, general counsel of the American Council of Life Insurers. With banks now as major competitors, "we do have to be agile competitors. If it takes you a year to get a product approved where [competitors] take a week, we're the odd man out. We can't be competitive . . . with a system of regulation that handicaps us to that degree."

"If Oxley can put together something that is truly a positive step, our view is, count us in," Hughes said.

Life insurance companies also complain of state regulators piling on in what is called "market conduct examinations." These are investigations into a company's marketing practices and can be quite time-consuming and expensive for the company. They hope to see a system that would require "deference" to such examinations done by regulators in a company's home state so that companies wouldn't face multiple exams done by a number of states one right after another.

Experts in and out of the industry say life insurers have an easier case to make for an optional federal charter or something resembling it. However, property insurance, especially automobile coverage, is a contentious issue in many states. Their goal of rate regulations will be tough to achieve, many say.

Backers of auto-rate deregulation argue that it works well where it has been used. They hold Illinois up as an example. That state accidentally deregulated rates in 1971 when its legislature was unable to agree on an extension of a temporary deregulation but then couldn't agree to reinstate the prior system. They argue that freeing rates encourages more companies to enter a state's market, resulting in competition that pushes rates down.

Csiszar said South Carolina has seen that since rates were deregulated in 1999.

Hunter countered that most of the new entrants have been "high-cost running mates" operated by insurers that were already there. The running mates specialize in "substandard" drivers, and South Carolina now allows companies to force more drivers to buy their insurance from them.

Hunter said consumers would benefit from greater efficiency. "Consumer don't want inefficient regulation since they pay for it," he said. One possible

approach would be tough minimum federal standards but with a provision to allow states to go further if they wished.

As it is, industry people, politicians and consumer advocates wonder how states could be compelled to follow the road map. Voters in such states as Massachusetts and California have demonstrated a clear preference for heavy regulation, and it isn't clear from the road map how they would be enticed or coerced into a different system.

"We have yet to define exactly how this federal-state partnership will work," Oxley said in his speech. He said mediation may be a solution, followed perhaps by "predetermined statutory penalties."

But he added, "We will not transfer any regulatory or licensing power, and we want this to be a full federal-state partnership."

The road map "is a good first step," said Julie Rochman of the American Insurance Association, a group of mostly big property insurers. But "there have to be some teeth," she said, which is why the group continues to favor a federal charter option.

"There's a contradictory statement in the road map," Hunter said. Oxley "says there will be no federal regulation, but how do you enforce it? . . . There's no carrot and no stick. They've painted themselves into a corner."