Consumer Federation of America
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Remarks of J. Robert Hunter, Director of Insurance,
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SECTION ONE

Good morning. It is an honor for Travis and me to be able to talk with you about issues consumers are concerned about in 2012. I'd like to thank Kevin and Terri for making our time here possible.

Several years ago, the nation's consumer groups published a white paper detailing eight guiding principles for developing high-level consumer protection standards in insurance regulation, including transparency of product and cost, access for all consumers to adequate coverage with no unfair discrimination, meaningful redress of harm, regulation that promotes competition and is accountable to the public and the creation of organized consumer input into regulatory decisions. Copies of these principles are in the packets we have passed out.

At the end of my remarks, I will give you our brief assessment of the progress that has been made in implementing these consumer protection principles. But I would like to begin with a short discussion of CFA's most recent initiative evaluating the auto insurance marketplace for working Americans.

AUTO INSURANCE FOR WORKING AMERICANS

Last Monday, CFA released a Ford Foundation-funded study focusing on the two-fifths of all households with incomes below $38,000. Our review of hundreds of scholarly and government sources made it clear that no one, including CFA, has adequately examined the cumulative effect on the affordability of mandated auto coverage of rating classifications commonly used by insurers. Unfortunately, we found not just high rates, but evidence of unfair and discriminatory treatment of working families that has resulted in the denial of economic opportunities.

Our research looked at the academic literature on the relationship between access to automotive transport and economic opportunities, especially jobs. The findings were clear, to quote from one study: "transportation problems predict employment outcomes." And more specifically, to quote from another study, "the impact of the auto in providing employment access to lower-skilled labor can hardly be overstated." In other words, working Americans are economically disadvantaged by the lack of a car.

The fact that so many of these families have a car -- two-thirds of low-income and 90 percent of moderate-income households -- suggests how important automotive transport is.

As you know, auto insurance purchase is mandatory for car owners. All states but New Hampshire require the purchase of liability or PIP coverage. And auto lenders require borrowers to carry collision and comprehensive coverage on financed vehicles.

So, most lower income households need a car and are required to purchase auto insurance. But this purchase represents a large and burdensome expenditure for many of these families. Our examination of federal data suggests that lower-income car owners spent an average of $823 for car insurance in 2010, about $30 billion in total. But since a significant minority of these car owners did not carry insurance, the average annual premiums of those who did exceeded $1000. For low-income families, the cost of auto insurance greatly exceeded the amount spent annually by these families on the car itself, including financing. For those in the first quintile, the average family income is under $10,000, making auto insurance often unaffordable.

A different question is, what is the lowest amount these consumers are required to spend for minimum liability coverage required by the state? This will of course depend on the characteristics and classifications used by insurers regarding individual drivers and their driving environments. Many lower-income drivers pay a high price for auto insurance, even if they have maintained a perfect driving record and drive relatively few miles.

We are not saying major insurers are trying to rip-off lower-income Americans. It is clear, however, that many insurers do not want to serve these drivers for several reasons, including the fact that profits are much higher with higher-income families, who own more and newer cars that almost always carry collision and comprehensive as well as liability coverage, and who often purchase other insurance, like homeowners', from their auto insurer.

Given costs like these, it's no wonder than a significant minority of lower income drivers -- we estimate 25-30% -- do not carry auto insurance, in violation of their state law.

In light of the fact that a large majority of drivers carry uninsured motorist coverage, which is required by many states, we considered calling for the elimination of mandatory insurance requirements. But we concluded that this elimination was neither socially nor politically feasible. However, we also strongly believe that, as a society, we must figure out a way for working families to purchase affordable liability coverage so that many don't have to choose between breaking the law and giving up access to job opportunities

Therefore, we propose several solutions to this serious problem, solutions we think are fair and practical and can be implemented or encouraged by insurance commissioners. I will briefly discuss some of them. There are two items requiring state legislation that we seek your support to achieve:

First: the commissioners should ask their state legislatures to consider lowering minimum liability coverage requirements. These state liability requirements do not directly benefit the many lower-income drivers who are effectively judgment-proof in any liability action because they have few or no financial assets. Lowering these limits to those required in Florida (PIP) and California, (tort) for example, would lower premiums and allow more working households to purchase insurance and obey the law. Efforts to raise these limits, as have occurred in several states recently, should be seriously questioned.

Second, legislatures should be asked to consider creating low-income auto insurance purchase programs. The only broad program to address the lower income auto insurance issue exists in California, which offers low-cost liability coverage to its lower income drivers. The premiums are low – the highest, in Los Angeles, is under $400 – because the program offers very low limits of liability coverage only to "good drivers." This program is not subsidized by taxpayers or by ratepayers. We would encourage you to look at this model and develop similar programs in your states. We also urge the NAIC to develop a model bill for this purpose. Even though the number of drivers participating in the California program is relatively low, at least it provides a better opportunity for all good low-income drivers to purchase more affordable mandatory coverage.

The most important need is squarely in your area of responsibility. Action is required to eliminate discrimination that occurs when low- to moderate income Americans are charged higher premiums due to questionable rating factors. Consider this example of a consumer purchasing auto insurance in the St. Louis area. The driver is a single man, age 30, driving since age 16, who owns a ford Taurus, has a perfect driving record, commutes round-trip 20 miles a day and buys a basic limits policy plus comprehensive and collision, both with a $500 deductible. Throughout the example, these factors do not change. If the man was an executive with an MBA living in an affluent suburb, his rate would be $558. But here is what happens as some factors are altered. If he were only a high school graduate, his rate would go up $71. If he became unemployed, his rate increases by an additional $84. If he moved to a nearby lower income zip code, his rate jumps an additional $347. If he chose to pay on an installment basis, his rate rises $60. If, for a period of time, he was uninsured, his rate jumps $638. If he didn't have a car for a while, his rate goes up $337. All these changes in total would drive his rate from $558 to $2,095. And the example would have been worse if we had assumed that a poor credit score replaced a good credit score in the test. The fact that this series of questionable factors raises a person’s rate almost fourfold shows how having a low to moderate income can lead to astonishingly higher rates. We do not ask for subsidies here, only that regulators ensure that insurers do not penalize consumers for being poor as the use of these factors and others, such as prior BI limits, does.

No study has ever been conducted of the aggregate impact of all these questionable factors on working Americans. Some of these factors, individually and, particularly in the aggregate, appear to be surrogates for income, which is forbidden from use in all states. The use of these proxy factors should be banned if it can be shown that their purpose is to skirt the prohibition.

In addition to the use of factors that appear to be surrogates for income, our research discovered, shockingly, that some insurers in some states charge more for low limits of coverage than for high limits, for the exact same person. This is like charging more for a little box of cereal than for a jumbo box. It appears that some insurers are discriminating against purchasers of the minimum coverage, who are disproportionately lower income.

If there is one priority that I would urge you to address, it is to make sure insurers do not penalize consumers on an income basis for the liability coverage required by state law. By driving inexpensive cars, low- to moderate-income households can avoid having to purchase collision and comprehensive coverage. But to comply with state law, they must purchase liability coverage. We suggest that your departments evaluate the fairness of rates charged to low- to moderate-income families, starting with rates for required liability coverage. Research disparate treatment and impacts and how to eliminate or reduce them. Give special attention to insurers who charge individual consumers higher premiums for minimum than for standard liability coverage. We request that the NAIC collect data about and use it to analyze the impact of all these rating factors. The D Committee should create a Working Group on risk classes charged with the collection of needed data, examination of the impact of risk classes on the availability and affordability of required auto insurance on everyone but particularly on lower-income Americans. We also urge the NAIC to hold a hearing on the matter so that all stakeholders can be heard.

I would also urge individual commissioners to require insurers to consider risk-related factors that are not used or inadequately used today, which would lower auto insurance rates for working families. One important factor is miles driven annually. Our research found that low-to moderate income car owners drive only about half the miles of those in the top income quintile -- but the lower risks associated with fewer miles driven are not adequately recognized by most rating systems, so these drivers do not get the full benefit. We ask that the states and the NAIC take steps to expedite expansion of the use of miles driven in setting rates.

CFA is making the improvement of the auto insurance marketplace for working consumers a high priority over the next few years. We are reaching out to civil rights groups and many organizations that work on consumer issues and concerns of importance to working Americans. We intend to survey each state on how they regulate auto insurance and provide relevant information to the public, and to release a national report on the findings. We really want to work with you all on this urgent matter.

Maybe we should stop here and take a few minutes of questions before I go on the rest of my presentation?

SECTION TWO

HOW CONSUMERS VIEW INSURANCE REGULATION TODAY

I should say that I do understand the major challenges commissioners face in achieving stronger consumer protection standards. We are very aware of the power of the insurance industry at the state (and federal) level. We know most states have little organized consumer input to balance the insurer lobbying they receive. We are aware of the inadequate resources many states have to carry out regulatory efforts. For example, all of the state insurance departments in the country employ only 218 actuaries, while Prudential alone has 287. We also know that in many states, legislators and governors can bring a lot of pressure to bear on behalf of insurers. I certainly experienced these things in Texas.

Our view of state regulation today is that it is doing extremely well in the critical area of solvency regulation and that the accreditation process has achieved a strong regulatory result. You should be proud of this accomplishment!

However, market conduct and consumer protection regulation has not kept pace. Market conduct exams I have reviewed over the years tend to be after-the-fact audits that, unfortunately, have often failed to identify significant abuses and are inherently inefficient because of lack of precise focus. A modernized market regulation system would use modern data-mining and predictive analytics to be more pro-active, effective and efficient. The failure is because of the absence of proper data and tools, not because the hard-working front-line market regulators are not trying hard to protect consumers.. Market conduct exams rarely dig deep enough to find hidden abuses; these tend to be discovered in litigation, not by examiners. We believe market conduct regulation should have it's own accreditation program and, when critical issues are being examined, experts should be brought in to help. Consumer protection regulation also needs enhancement. We point to California as a model for excellence in review of products and prices, because vigorous competition exists and rates have increased well below the national average.

The most important characteristic of an effective market regulation program is proactively identifying practices and even entire markets (like credit insurance in many states) that are dangerous for consumers, and by promoting competitive markets which reward good players and don't allow bad players to participate. An effective market regulation program is an efficient one, because it will focus on problem companies and not on all companies, and will rely more on market forces to discipline market participants because of greater consumer market power. We certainly support greater economic efficiency when consumer protection standards are high, but we are concerned that "efficiency" is often a code word for less oversight of problematic practices and more industry self-regulation, which in often ineffective. A recent contingent annuity product was approved in many states, as the Life Actuarial Task Force put it, "without proper vetting" and now is being redone. Speed-to-market can lead to huge regulatory and consumer costs. It is much cheaper to have a high-quality up-front approval process.

An effective market regulation program will have the following characteristics:

1. **Detailed transaction level data collection by regulators to perform data mining and predictive analytics** -- data to empower regulators to use 21at century tools to review 21st century practices.
2. **Collection and publication of insurer market performance data to enable the public**

to hold insurers and regulators accountable for their practices -- HMDA style data collection

3. **Best practices for consumer disclosures** -- guidelines for identifying when disclosures may be effective to address a market problem and empower consumers and best practices for developing effective disclosures when disclosures are appropriate. **However, disclosures cannot solve every market problem, such as the use of discriminatory rate classifications, and they should not be viewed as an all-purpose fix for every abusive practice.**
4. **Greater transparency in forms and rates, including new tools to empower consumers to shop effectively. We recommend replacing premium comparison tools** -- which use very simple rating characteristics when insurers are using a variety of new rating characteristics whose weight dwarfs that of the traditional factors -- **with information on actual rating factors used by insurers and the relative weight of those factors for those insurers. We also suggest developing meaningful policy comparison tools and claims' settlement evaluation tools for consumers, and improving the usefulness of consumer complaint information by making it more detailed with ratios calculated based on averages, not medians as it is now.**
5. **Modernize the regulation of risk classifications** -- insurers' ability to data mine and utilize predictive analytics, combined with emerging databases, means that almost any characteristic or behavior of the consumer is available as a risk classification. The current standard -- simple correlation -- is grossly inadequate and opens the door to unfair rating factors that undermine the critical role of insurance in loss mitigation. Classes must be based on a logical, explainable, legitimate relationship to risk. Our report and the research we have done raises serious doubts about whether a number of the classes and factors used by insurers are truly related to risk. In the aggregate, it is clear that the total impact is not, in fact, risk related.

There are two specific consumer abuse issues that we'd urge the NAIC and the states to focus attention no in 2012:

1. Unregulated "black box" models used by insurers for pricing and claims. Credit scoring and catastrophe (CAT) models greatly impact price. The use of Colossus, and usual and customary models like Ingenex, greatly impact the size of claims paid by property/ casualty insurers. Yet the model developers are unregulated and the models often not sufficiently vetted by the regulators. It appears that some companies that develop these models often compete for market share with insurers by engineering the models to justify higher rates (such as the discredited short-term CAT model developed by Risk Management Solutions) or unfairly lower claim payouts (such as with Colossus and Ingenex). Not enough has been done by the states to understand how these systems work. (Two notable exceptions are Florida's work on CAT modeling and the Illinois market conduct study of Allstate's use of Colossus.) **The states should examine the impact on consumers of unregulated third-party models and move to regulate them as advisory organizations.**

2. Credit-related insurance products, such as credit, title, and forced-placed insurance suffer from "reverse competition" and thus unjustifiably high rates. Force-placed insurance, a

truly abusive system of "kickbacks" to lenders, is finally getting serious attention in a comprehensive New York State examination. The *New York Times* and other media outlets have taken a great interest in this subject as well. Reverse competition occurs because the lender, not the consumer, selects the insurer and the lender looks for more compensation from the insurer, rather than lower costs for consumers. Because some states have imposed effective loss ratio caps on pricing on credit insurance, many lenders have shifted from state insurance-regulated products to very similar debt cancellation products overseen by banking regulators. **The states should enhance the regulation of credit-related insurance, including force-placed insurance and work with banking agencies and the CFPB to determine if these products falls between the regulatory cracks and how regulatory arbitrage can be ended.**

Terri Vaughn asked that I spend a minute on the experience I had as Administrator of the Federal Insurance Administration, when FIA had powers similar those that have been recently granted to the Federal Insurance Office, the FIO. The FIA had significant power based on a White House delegation of authority to us to be the eyes and ears of the federal government on insurance matters. Richard Nixon initially gave the FIA this authority, which was maintained by Gerald Ford and Jimmy Carter. We were required to work with a wide range of agencies on insurance concerns related to their jurisdiction. For example, we developed a federal no-fault auto bill with DOT, and a national health insurance bill with what was then called HEW. We administered insurance pricing when there was a Price Commission; we worked to develop the first liability risk retention act as a response to the mid-1970s liability crisis. We studied the crisis both with other federal agencies and the NAIC, and worked to get product liability and medical malpractice lines broken out on annual statements. We also worked with the NAIC on a med mal closed-claims study, and on development and regulation of FAIR Plans, which was the quid-pro-quo for federal riot reinsurance. Of course, we also worked with the states on other issues as they arose during the 1970s, often acting as a researcher and advisor. For example, we wrote a book on how to improve home and auto insurance residual markets that several states used to improve their plans. I think we had a partnership, which might be a model for working with the FIO.

Speaking of partnership, CFA would like to be a partner with the states and the NAIC on finding solutions to these and other serious consumer problems over the coming months. We look forward to working with you.

Thank you. Any questions?