Testimony of Birny Birnbaum
Executive Director
Center for Economic Justice

Before the

Subcommittee on Insurance, Housing and Community Opportunity
Committee on Financial Services
U.S. House of Representatives

"Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs"

July 28, 2011

Chairman Biggert, Ranking Member Gutierrez and members of the Subcommittee, my name is Birny Birnbaum. I am the Executive Director of the Center for Economic Justice, a non-profit organization advocating on behalf of consumers on insurance, credit and utility issues. I have been intimately involved in insurance regulatory policy issues for 20 years as a regulator and as a consumer representative. I have been an active participant at the National Association of Insurance Commissions (NAIC) and the National Conference of Insurance Legislators (NCOIL) for many years.

The vast majority of state insurance regulators – particularly those in market regulation – are incredibly dedicated to consumer protection. I have had the honor of working with hundreds of these state insurance regulators over the past 20 years. But these regulators are limited by a lack of essential tools – data for market analysis – and by a regulatory structure that favors insurers over consumers. There are some clear actions states can take to level the insurance regulatory playing field and make regulators and insurers more accountable to consumers.

My testimony today will cover:

- Accountability and Responsiveness of Insurance Regulators and Insurers to Consumers
- The Limitations of State Insurance Market Regulation Efforts
- The Dodd Frank Requirements for Studies of Insurance Availability
- Problems with Force-Placed Homeowners Insurance

Accountability of Regulators and Insurers to Consumers

The insurance regulatory system has limited accountability to consumers and routinely favors insurance industry interests over consumer interests.

There is a tremendous imbalance in the ability of the insurance industry – versus consumers – to influence insurance regulatory policy and regulatory performance. The insurance industry spends hundreds of millions of dollars of funds provided by consumers – paid as part of the insurance premiums – to lobby regulators and legislators at the NAIC, NCOIL and in individual states. In the vast majority of states, there are no consumer organizations focusing on insurance issues other than health insurance. So, for the vast majority of regulatory issues, there are no consumer perspectives to balance out the many industry voices pushing for the industry policies. Even when there is a consumer voice, it is typically outnumbered and outspent by massive amounts.

Today’s hearing is an example of this imbalance. Six industry representatives representing nine industry trade associations are testifying today. I am the sole consumer representative.

The absence of consumer insurance advocates – individuals and institutions with resources necessary to participate in the regulatory process – contributes to an insurance regulatory system that is far more accountable to industry than to consumers. This is most pronounced for state insurance regulatory administrative actions – rulemaking, enforcement and market surveillance. Industry has virtually unlimited funds to press their views and fund research to serve their cause – funds provided by policyholders from premium payments. As a result, insurance regulatory policy and actions routinely favors insurers over consumers.

The regulatory bias towards industry is exacerbated by weak conflict of interest requirements regarding movement of regulators to industry. When regulators leave public service, the vast majority go to work for the industry they regulated – often lobbying their former colleagues on behalf of industry. Few go to work on behalf of consumers because there are few jobs available for insurance consumer advocates.

To level the playing field and make insurance regulation more accountable to consumers, insurers should be prohibited from including lobbying expenses in insurance premiums. Alternatively, insurers should be required to obtain affirmative agreement – opt-in – by consumers for use of premium dollars for lobbying. In addition, there should be mechanisms in place to fund independent insurance consumer advocates. There are a number of models for this, ranging from state agencies like the Texas Office of Public Insurance Counsel to consumer-funded Consumer Insurance Boards. Of course, conflict of interest requirements should also be strengthened to ensure that today's regulatory actions are not influenced by tomorrow's job prospect.

Another critical tool to improve the accountability of insurers and regulators to consumers is the public availability of insurer market performance data – the insurance equivalent of Home Mortgage Disclosure Act Data.

State Insurance Market Regulation

Market regulation is the term used to describe regulators' activities to monitor insurance markets, identify market problems and consumer abuses and remedy those problems. Although one of the most oft-heard arguments for state-based insurance regulation is that the states better understand and are closer to their markets than a federal regulator, the fact is that state regulators have a poor track record of identifying the worst market problems. Indeed, many of the worst insurance consumer abuses were identified by others – state attorneys general, news media or consumers going to lawyers for assistance. The list of market problems not identified by state insurance regulators is impressive:

- Bid Rigging Associated With Contingent Compensation of Brokers
- Homeowners and Auto Insurance Redlining
- Financed Single Premium Credit Insurance Sold With Real Estate Loans
- Churning of Life Insurance Policies
- Unsuitable Sales of Annuities to Seniors
- Life Insurer Claim Settlement Practices and Retained Asset Accounts
- Unfair Underwriting and Rating Factors

The limitations of state insurance market regulation have been recognized by the Government Accountability Office (GAO) and by Congress. The GAO has issues several reports examining state insurance regulation. In a 2003 report[1], the GAO stated:

> While all states do some kinds of market regulation, including issuing licenses and responding to consumer complaints, two key tools—market analysis and on-site examinations—are used inconsistently, if at all. The result is inconsistent and often spotty coverage from state to state and potential gaps in consumer protection. Formal and rigorous market analysis, which could be used to determine which companies to examine and how broad the examination should be, is in its infancy among state regulators, and states that do perform examinations vary widely in the way they choose companies to examine and the scope of the examinations they conduct. These inconsistencies in performing market conduct examinations make it difficult for the states to depend on each other for regulation, leaving each state with the virtually impossible task of examining every company within its borders. And with each state conducting its own examinations, some insurance companies find themselves undergoing simultaneous examinations by several states, while other companies may not be examined at all.

In a follow up report in 2009[2], the GAO found limited improvement and stated, "NAIC and the states have taken steps to improve reciprocity and uniformity of market regulation, but variation across states has limited progress."

Congress has also taken note of the states' failure to examine insurance markets for unfair discrimination. In the 2003, Congress passed the Fair and Accurate Credit Transactions Act, which required the Federal Trade Commission, in consultation with the Office of Fair Housing and Equal Opportunity of HUD to study the effects of credit-based insurance scores on the availability and affordability of property and casualty insurance, the statistical relationship

---

[1] "Insurance Regulation: Common Standards and Improved Coordination Needed to Strengthen Market Regulation," General Accounting Office, September 2003

[2] "Insurance Reciprocity and Uniformity: NAIC and State Regulators Have Made Progress in Producer Licensing, Product Approval, and Market Conduct Regulation, but Challenges Remain," Government Accountability Office, April 6, 2009

between credit-based insurance scores and actual losses, and the extent to which credit-based insurance scores are a proxy for prohibited factors, such as race, color, or religion. Despite being responsible for regulating insurers' use of consumer credit information for underwriting and rating, state regulators have collected very little information on, for example, the impact of the great recession on insurance scores and premiums.

More recently, in the Dodd Frank Act, Congress created the Federal Insurance Office (FIO) and authorized the FIO to monitor the extent to which traditionally underserved communities and consumers, minorities and low- and moderate-income persons have access to afford able insurance products regarding all lines of insurance, except health insurance. Congress also gave the FIO the authority to collect data from insurers, to the extent the data is not already collected by state insurance and other regulators.

These directives by Congress are a result of the failure of state insurance regulators to collect meaningful market performance data about insurers. Currently, state regulators receive and review consumer complaints and have started to collect a few pieces of data through the Market Conduct Annual Statement (MCAS). But these data are grossly inadequate for rigorous market surveillance and analysis. The absence of consumer complaints is <u>not</u> a reliable indicator of fair treatment of consumers; some market problems did not produce consumer complaints because the consumer was not aware of the problem (bid rigging/broke compensation, retained asset accounts) or did not know to file a complaint with the insurance department. The MCAS, which has great potential to assist regulators in improving market regulation, fails to meaningfully help regulators because there are so few data elements and the data elements collected are so highly summarized.

The failure of state insurance regulators to collect – and publish – insurer market performance data contrasts starkly with market performance data available to regulators and the public for mortgage and other lending through the Home Mortgage Disclosure Act (HMDA). With HMDA, lenders report information on all loan applications and resulting loans. The availability of HMDA data allowed fair lending organizations to identify predatory lending abuses in the subprime mortgage market as early as the late 1990's and the reckless mortgage lending practices that led to the financial crisis of 2008 in the early 2000's.

One of the most important actions state insurance regulators can take to improve market regulation, consumer protection and accountability of insurers and regulators to the public is to collect and publish detailed market performance data about individual insurers in the same way that HMDA data are collected and published for lenders' market performance.

Force-Placed Insurance

Lender-placed insurance (LPI) is also known as force-placed insurance, is insurance placed by a lender on collateral supporting a consumer loan in the event the borrower fails to maintain required insurance coverage. For example, a mortgage lender will require property insurance to protect the real estate serving as collateral for the loan. Lenders (or, more typically, the insurer providing the LPI and administering the program for the lender) monitor the insurance status of the property and auto loans to ensure the required insurance is in place. If the lender or insurer/program administrator determines the insurance is not in place, an insurance policy (or certificate on a group policy) is issued to cover the property or auto. The cost of the force-placed insurance is added to the loan.

The incentives and potential for abuse in the administration of LPI are great. Consumers do not request the insurance, but are forced to pay for it. The cost of LPI is much higher than a policy the borrower would purchase on his or her own. Lenders have incentive to force-place the insurance because the premium includes a commission to the lender and, in some cases, the insurance is reinsured through a captive reinsurer of the lender, resulting in additional revenue to the lender from the force-placement of the coverage.

With the great problems in the mortgage market and the crushing impact on low- and moderate-income consumers of the recession caused by the financial market collapse, the amount of force-placed homeowners insurance has exploded in recent years. According to Credit Insurance Experience Exhibit (CIEE) Data, insurers wrote $1.5 billion of gross premium in 2004. By

2009, that amount had grown to over $5 billion and, in 2010, LPI gross written premium grew to over $5.5 billion.

The prices for residential property LPI are significantly excessive. In 2009, insurers paid only 16% of net premium in claims and in 2010 the ratio was 17%. Incredibly, lenders get a commission – totaling hundreds of millions of dollars – out of these premiums, despite the fact that the insurance is placed to protect the lenders' collateral. The premiums also include the costs of tracking all the loans in the lenders' portfolios to identify those loans without insurance – so the lenders' cost of tracking all loans is passed only to those consumers paying for force-place insurance.

The problems with force-placed insurance illustrate a number of state regulatory failures. In this instance, regulators collect the data to indicate a problem with overcharges. But, state regulators have not taken action on their own initiative to reduce the rates for LPI. The problems with LPI have been brought to regulators' attention – at NAIC meetings and in correspondence with individual state regulators – but regulators have not taken action in response to the problems raised by consumers. Problems other than excessive rates were not identified by regulators, but by reporters[3] and consumer representatives because regulators collect no data on the sales practices and servicing practices of the handful of insurers writing the vast majority of the LPI business.

While the problems with insurance market regulation are significant, there are some clear actions, as described in my testimony, states can take to level the insurance regulatory playing field and make regulators and insurers more accountable to consumers.

[3] "Ties to Insurers Could Land Mortgage Services in More Trouble," Jeff Horwitz, *American Bankers*, November 10, 2010.

Birny Birnbaum

Center for Economic Justice
1701 A South Second Street
Austin, TX 78704
(512) 448 3096

Birny Birnbaum is a consulting economist and former insurance regulator whose work focuses on insurance regulatory issues. Birny has served as an expert witness on a variety of economic and actuarial insurance issues in California, New York, Texas and other states. Birny serves as an economic adviser to and Executive Director for the Center for Economic Justice (www.cej-online.org), a Texas non-profit organization, whose mission is to advocate on behalf of low-income consumers on issues of availability, affordability, accessibility of basic goods and services, such as utilities, credit and insurance.

Birny has authored reports on insurance markets, credit scoring, redlining, title insurance and credit insurance for CEJ and other organizations. Birny served on the National Association of Insurance Commissioners Consumer Board of Trustees. Birny has been particularly active on issues involving data collection for market surveillance and market analysis, the role and effectiveness of consumer disclosures and insurance market conduct issues. He has authored reports to numerous public agencies, including the California Department of Insurance, the Florida Insurance Commissioner's Task Force on Credit Scoring, the Ohio Civil Rights Commission and the Cities of New York and Philadelphia.

Birny served for three years as Associate Commissioner for Policy and Research and the Chief Economist at the Texas Department of Insurance. At the Department, Birny provided technical and policy advice to the Commissioner of Insurance and performed policy research and analysis for the Department. Birny was also responsible for the development of data collection programs for market surveillance.

Prior to coming to the Department, Birny was the Chief Economist at the Office of Public Insurance Counsel (OPIC), working on a variety of insurance issue. OPIC is a Texas state agency whose mission is to advocate on behalf of insurance consumers. Prior to OPIC, Birny was a consulting economist working on community and economic development projects. Birny also worked as business and financial analyst for the Port Authority of New York and New Jersey. Birny was educated at Bowdoin College and the Massachusetts Institute of Technology. He holds two Master's Degrees from MIT in Management and in Urban Planning with concentrations is finance and applied economics.

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	**2. Organization or organizations you are representing:**
Birny Birnbaum	The Center for Economic Justice
3. Business Address and telephone number:	
[redacted]	
4. Have <u>you</u> received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	5. Have any of the <u>organizations you are representing</u> received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?
☐ Yes ☑ No	☐ Yes ☑ No
6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
7. Signature: Birny Birnbaum	

Please attach a copy of this form to your written testimony.