APPENDIX F – Insurance Reform

Americans for Insurance Reform
"PROTECTING RIGHTS, NOT WRONGS"

May 11, 2004

To: Insurance Commissioners
50 states and the District of Columbia

URGENT ACTION REQUIRED BY INSURANCE COMMISSIONERS TO END PRICE-GOUGING

Dear Commissioner:

Americans for Insurance Reform is a coalition of over 100 consumer and public interest groups, representing more than 50 million people from around the country, which supports effective insurance industry reforms to end the price-gouging of policyholders.

On July 30, 2002, we called on each insurance commissioner to take specific steps to prevent large rate increases and tight underwriting that accompanies the start of the cyclical hard market. These conditions were then beginning to have a severe impact on certain policyholders, particularly in the personal lines (auto and homeowners) as well as the commercial lines (particularly property and medical malpractice).

We documented the cycle and the events occurring in 2001 and early 2002 as the market turned from soft to hard in a classic insurance cyclical turn. We asked that you analyze the events then unfolding, particularly looking at the degree to which the pattern being observed was the result of low interest rates and stock market problems. We asked that you study what seemed to us to be the beginning of over-reserving of claims in some lines, perhaps to hide profits and to support excessive rate increases. We asked that price hikes being sought be carefully analyzed to determine if prices were going up too much. We suggested a brief rate freeze while these studies were made. We asked that you inform your state legislators that these increases were often cycle-related and not reflective of any unexpected jump in claims requiring limits on recoveries of injury victims. We asked that you prevent insurers, such as State Farm, from overreacting by not writing new business in many states.

The letter engendered very tepid responses by most commissioners: only a few took the steps we suggested to protect consumers. Rates skyrocketed with insufficient oversight in most states. Few states analyzed to see if rates were too high, although a few did stop some rate increases and rolled back a few as well. Not many commissioners analyzed the reserving practices of the insurers. Few stopped insurers from cutting writings and limiting coverage. Few commissioners

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advised their legislatures that the jump in rates did not require legal system limits but was simply a cyclical phenomenon of the industry.

Since that time, great pressure was brought to bear on state legislatures around the country to enact tort law restrictions, and many states succumbed, relying on promises by insurance and health industry lobbyists that "tort reform" would reduce insurance prices even though it was clear they would not. Now, almost two years later, we have seen the unfortunate consequences of the failure to act by many insurance departments, in the major personal and commercial lines of insurance, including medical malpractice.

In the malpractice line, a tremendous amount of fear and anger has been created among doctors and patients alike. For example, in Illinois, a state that does not regulate insurance rates, doctor-owned ISMIE Mutual Insurance, the largest med-mal insurer in Illinois, turned a $20 million profit and added $31 million to its reserves. At the same time, rather than lower rates in light of soaring profits, it *raised* premiums 35 percent for its doctors while two senior executives received pay hikes of 12 to 18 percent, raising their annual salaries above $600,000. According to an April 21, 2004, *Chicago Sun-Times* article, the company is now facing a grassroots revolt by the rank and file member doctors over the company's failure to reduce rates.[1]

In Missouri, Department of Insurance Director Scott Lakin released a report on April 16, 2004, that said that "the top three insurers for physicians – Medical Assurance Co., Medical Protective Co. and Intermed – all posted profits last year, totaling $60 million, compared to after-tax losses of $21.2 million in 2002" but that "encouraging trends in the data have not yet affected pricing of the state's medical malpractice insurers for physicians. The top three insurers raised their rates 19, 26 and 82 percent last year. (MDI does not approve rates under state law.)"

Moreover, over-reserving is still a problem. In Missouri, for example, Lakin noted that in 2003 malpractice companies in Missouri did not drop reserving for future losses even though the number of filed claims declined sharply and the severity of injuries fell slightly. (Lakin says, "Medical malpractice claims filed and paid fell to all-time lows in 2003 while insurers enjoyed a cash-flow windfall.")

MED MAL VERDICTS AND LAWSUITS ARE STEADY OR FALLING. According to the most recent national data released, jury awards for medical malpractice cases have remained level in the latest three years and medical malpractice case filings per capita have been steady for 10 years.[2]

Based on preliminary data from the NAIC,[3] the country-wide 2003 medical malpractice paid loss to written premium ratio was 54.2% and the incurred loss to earned premium ratio was 80.6% --

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[1] Jim Ritter, "State Doctors, Malpractice Insurer Battle over Rate Hike, Board Raises," *Chicago Sun-Times*, April 21, 2004.
[2] "Malpractice Awards Remain Flat," *Wall Street Journal*, April 1, 2004. Jury Verdict Research is the source for this statistic, so it is likely the drop is even more significant as JVR data is highly inflated. See: http://www.centerjd.org/press/release/020322.pdf; National Center for State Courts, *Examining the Work of State Courts, 2002: A National Perspective from the Court Statistics Project* (Brian J. Ostrom *et al.* eds., 2003).
[3] The NAIC does not endorse any analysis or calculation based upon the use of its data.

down dramatically from 65.0% and 93.0%, respectively, in 2002. With improved investment income results in 2003, it now seems clear that the push for radical "tort reform" was an unnecessary overreaction to problems in the med mal markets.

Today, the situation is clear. Property/casualty insurance company profits are astounding and the hard market is over, but the damage to consumers, particularly to doctors, small businesses and individual consumers will live on.

2003 PROPERTY-CASUALTY INDUSTRY PROFITS ARE SOARING. Profits were $29.9 billion last year—almost 10 times the $3 billion recorded in 2002. Much of this was due to a "steep decline" in net losses on underwriting--down 85 percent to $4.6 billion in 2003 from $30.8 billion in 2002.[4] Even more astounding is the 21.7% increase in industry surplus – fully $63 billion – during 2003.[5]

Consider the outstanding 2003 profits of the top five stock insurance groups in the nation: Allstate, American International Group (AIG), Zurich, Berkshire Hathaway and Travelers, with written premiums of $23.3 billion, $21.0 billion, $17.4 billion, $15.2 billion and $11.9 billion respectively. (State Farm, the nation's largest insurer at $42.7 billion, is a mutual insurer specializing in personal lines coverage.)

2003 profits were as follows:

Allstate: $2.3 billion (16.5 percent return on equity (ROE))
AIG: $9.3 billion (17.2 percent ROE)[6]
Zurich: $2.1 billion (12.5 percent ROE)
Berkshire Hathaway: $8.2 billion (16.2 percent ROE)
Travelers: $1.7 billion (17.4 percent ROE)

Low loss ratios indicate excessive rates throughout personal and commercial lines of insurance. The countrywide 2003 private passenger loss ratio (incurred to earned) was down to only 62.8% -- below 70% in every state and below 60% in 18 states.

The 2003 homeowners' loss ratio was 59% in 2003, following a loss ratio of 65.8% in 2002. In 19 states, the loss ratios were under 50% in 2003 – six with loss ratios under 40%.

In the fire and allied lines, the 2003 loss ratios were only 39.4% and 46.8%, following loss ratios in 2002 of only 35.7% and 43% in 2002.

There is clearly a question about how well "competition" protects consumers from excessive insurance rates. Consider the following news reports from late 2003:

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[4] Daniel Hays, "P-C Industry Sees Profits Skyrocket in 2003; However, concerns raised about rate hike moderation, Wall Street uncertainty," *National Underwriter,* April 19, 2004.
[5] AM Best Statistical Report, Advanced Financial Results, Property Casualty Writers, 2003, April 12, 2004.
[6] AIG reported a $2.84 billion profit in the first quarter of 2004, a jump in profits in that quarter of 20% over the already high profits of a year earlier.

Greenberg, Schiro Make Pleas for Pricing Discipline, *BestWire*, November 24, 2003:

> With many fearing the hard-market cycle might have run its course, the chief executive officers of two of the world's largest insurance companies both called on the industry to follow their lead in preserving adequate rates.
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> In separate addresses before the 15th annual Executive Conference for the Property-Casualty Industry in New York City, American International Group Inc.'s chairman and CEO, Maurice "Hank" Greenberg, and James Schiro, CEO of Zurich Financial Services Group, each talked about holding steady.
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> "We absolutely need to hold the line on pricing and not give in to excessive competition," Greenberg said.
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> . . .
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> "We have to remind everybody to stop at the stop signs," he [Schiro] said. "When you see there have been combined ratios above 100 since the early 1980s, it's more important than ever to remember that we must earn the cost of our capital. Let's not get pushed into a soft market. We're just simply not ready for a soft market."
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> . . .
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> "When I speak to people in this industry, in my own company, I try to remind them that we are not in the 'insurance business,' we are in the business of making money," [W.R. Berkely Corp. chairman and CEO, William R.] Berkley said. "What drives the cycle is people thinking they are in the 'insurance business.'"

CEOs' Pledge To Hold The Line Against Soft Market, Sam Friedman, *National Underwriter Online News Service*, Nov. 21, 2003:

> Insurance company executives lectured, scolded and even pleaded with their counterparts to hold the line on underwriting discipline and resist any temptation to prematurely soften property-casualty market prices, during an industry conference here.
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> "Let's not get in a race for marketshare," he [Schiro] said, adding that "we need several more years of profitability" to reach an acceptable return-on-equity for the risks being underwritten by the industry—a theme emphasized again and again by CEOs speaking at the meeting.

These accounts describe anti-competitive behavior and efforts at cartel pricing. Yet, we are unaware of any state taking an action against any of these companies for this anti-competitive behavior.

The absence of price competition also appears in personal auto insurance. Virtually every personal lines insurer reported record profits in the first quarter of 2004.

Allstate first quarter 2004 profits rose 42.7%, with a combined ratio of 86.4%.[7]

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[7] "Allstate Credits P/C Underwriting for Strong First-Quarter Net," *BestWire, April 21, 2004.*

Progressive seemed embarrassed by its level of profitability. With Progressive's first quarter 2004 profits up 58%, and a combined ratio 83.2%, CEO Glenn M. Renwick said during a conference call: "While we always plan to make a profit, the margins we experienced through March are larger than we anticipated and planned for in our pricing."[8]

Despite record profits and loss ratios far below levels associated with reasonable profits, the Insurance Information Institute is predicting increased average premiums for private passenger auto in 2004.

Instead of reducing rates to reflect lower claim costs, we see increased spending on advertising by insurers.

THE INDUSTRY'S ECONOMIC CYCLE HAS TURNED. The Council of Insurance Agents & Brokers reports that commercial property/casualty premium increases have eased greatly and are now returning to the levels they were at the end of 1999. As of the first quarter of 2004, large commercial businesses had rates drop by 3 percent from a year earlier; mid size commercial businesses had their rates rise by only 1 percent and small businesses had a rise of only 3 percent.

	2001	4Q 2002	4Q 2003	1Q 2004
OVERALL RESULTS				
Small Comm. Accounts	21%	8%	4%	3%
Mid-size Comm. Accounts	32%	19%	5%	1%
Large Comm. Accounts	36%	21%	4%	-3%
SPECIFIC LINES				
Business Interruption	30%	13%	2%	-1%
Construction	46%	34%	13%	8%
Commercial Cars	28%	18%	7%	3%
Property	47%	21%	5%	-5%
General Liability	27%	19%	6%	3%
Umbrella Liability	56%	34%	11%	4%
Workers' Compensation	24%	21%	9%	4%
D&O		32%	13%	7%
Employment Practices		32%	10%	5%
Medical Malpractice		63%	34%	19%
Surety Bonds		18%	7%	6%
Terrorism		63%	2%	0%

Calculated by Consumer Federation of America from the Council of Insurance Agents and Brokers Commercial Property-Casualty Market Survey (By quarter as indicated)

Even in the med mal line, rate hikes have slowed down as well (although not enough), dropping from 63 percent in the fourth quarter 2002 to 19 percent in the first quarter 2004. Increases will

[8] "Progressive's Net Income Climbs 58% in First Quarter," *BestWire*, April 16, 2004. Source for combined ratio: "Progressive First-Quarter Profit Up 58%," National Underwriter News Online, April 16, 2004.

be above inflation for only one or, at most, two more quarters, even in this line of insurance. Other lines are already in single digits and some lines are experiencing rate reductions – a sure sign that the soft market is upon us. Rates will then be flat to down (at least in constant dollars) until the next cycle turn, probably a decade or more from now.

Therefore, we urgently call on all insurance commissioners to take these major steps at this time:

1. Undertake a review of rate levels to determine if rates are excessive in any line of insurance. For example, rates have been rolled back in homeowners insurance in Texas after a study there determined that rates were excessive. It is clear that inaction by most states to control rates during the last two years has left some states with excessive prices in some insurance lines, particularly auto insurance, home insurance, commercial property lines and medical malpractice.
2. Initiate an investigation into anti-competitive behavior of insurance companies in making statements and other acts to hold off competition as evidenced in the articles cited above.
3. If any insurer files a rate request in excess of current inflation for that line of insurance, a rate hearing should be called. For instance, if a medical malpractice insurer files a rate request greater than current medical inflation, require a hearing. If state law does not permit this, ask state lawmakers to amend this law to allow such a hearing.
4. As there is now plenty of time before the next hard market hits, begin the process of careful analysis as to what led to this most recent cycle, and your department's role in it by allowing rates to fluctuate between excessive (such as now at the end of the hard market) and inadequate (such as right before the turn in the market from soft to hard). There is plenty of time now to analyze exactly how to control these prices before the next turn.
5. Alert your legislature to the end of the hard market and advise them that there is no need to rush into legislative fixes, such as legal limits on victims' rights. There is a decade or so to really sort out what needs fixing, other than the cycle which requires insurance regulatory reform. Commissioners should use the time wisely.
6. Review successes from other states in averting the same sort of price spikes you may have endured over the last two years. Clearly, insurance rate regulation is one thing that has helped tremendously to prevent large rate increases in some states. Nowhere has this been more evident than in California, a state that in 1988 passed the strongest insurance reform law in the country.[9]

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[9] For example, in September 2003, the California Insurance Commissioner ordered the state's second largest medical malpractice insurer, SCPIE Indemnity, to slash its proposed rate increase for doctors by 36 percent after an eight-month regulatory investigation of the firm's rate request. The investigation was conducted pursuant to California's 1988 insurance reform law, Proposition 103, which created a "prior approval" regulatory system that requires insurers to justify rate hikes and allows the public to challenge rate requests greater than 15 percent. The ruling was in response to the first-ever consumer group challenge to a medical malpractice insurance rate hike request, brought by the Foundation for Taxpayer and Consumer Rights (FTCR), a California nonprofit organization. SCIPIE requested a 15.6 percent hike but the Commissioner allowed only a 9.9 percent increase. According to the FTCR, "the net impact is a $16 million savings for the insurer's 9,000 physicians in 2003 and an additional $7.2 million of savings in next year's premiums."

The California experience demonstrates strongly that regulation of insurance rates and other insurance reforms are the key to controlling the sharp ups and downs of the cycle and preventing these kinds of crises in the future.

As we said in our July 2002 letter, you are the official charged with regulating the insurance industry and protecting the interests of insurance consumers in your state. Therefore, you have a unique and pressing obligation to take steps to reform regulation of the insurance industry, which consistently looks for others to blame when a hard market hits, although it is again clear that this scapegoating is merely a cover up for the industry's own mismanagement.

Thank you for your time and consideration of our concerns. Please do not hesitate to contact us with any questions or comments.

Sincerely,

J. Robert Hunter
Director of insurance
Consumer Federation of America

Birny Birnbaum
Executive Director
Center for Economic Justice

On behalf of Americans for Insurance Reform:
Alabama Watch, AL
Alaska Public Interest Research Group, AK
Arizona Coalition Against Domestic Violence, AZ
Arizona Consumers Council, AZ
Arkansas Advocates for Nursing Home Residents, AR
Association for the Protection of Our Elderly, CA
Boston Women's Health Collective, MA
California Advocates for Nursing Home Reform, CA
Caribbean Women's Health Association, Inc., NY
Center for Economic Justice, TX
Center for Insurance Research, MA
Center for Justice & Democracy, NY
Citizen Action/Illinois, IL
Citizen Action of New York, NY
Citizens' Committee to Protect the Elderly, VA
Citizens' Environmental Coalition, NY
Citizens for Consumer Justice, PA
Citizens' Health Advocacy Group, WA
Coalition for Consumer Rights, IL
Colorado Progressive Coalition, CO
Colorado Public Interest Research Group, CO
Community Food Resource Center, NY
Concerned Citizens of Clarence, NY
Connecticut Public Interest Research Group, CT
Consumer Federation of America, DC
Consumers for Civil Justice, NJ
Consumers United/Minnesotans for Safe Foods, MN
Cornerstone, MN
Dalkon Shield Information Network, PA
Democratic Processes Center, AZ
DES Action, CA
Jennifer Dingman, PULSE of Colorado, CO*
Disabled in Action of Metropolitan New York, NY
Empire State Family Farm Alliance, NY
Families Advocating Injury Reduction, IL
Families for Improved Care, OH
Florida Consumer Action Network, FL
Florida Public Interest Research Group, FL
Foundation for Spinal Cord Injury, Prevention, Care and Cure, MI
Foundation for Taxpayer and Consumer Rights, CA
Free Hand Press/Mouth Magazine, KS

Georgia Coalition Against Domestic Violence, GA
Georgia Public Interest Research Group, GA
Georgia Watch, GA
Good Old Lower East Side, NY
Gray Panthers National Office, DC
Greater New York Labor-Religion Coalition, NY
Headway for Brain Injured, Inc., NY
Homeowners Against Deficient Dwellings, MO
Illinois Public Interest Research Group, IL
Indiana Public Interest Research Group, IN
Joint Public Affairs Committee for Older Adults, NY
Kaiser Permanente Reform Committee, CA
Maryland Consumer Rights Coalition, MD
Massachusetts Public Interest Research Group, MA
Mental Health Association of New York State, Inc., NY
Michigan Consumer Federation, MI
Minnesota Consumers Alliance, MN
Regene Mitchell, Consumer Federation of California, CA*
National Community Reinvestment Coalition, DC
National Fair Housing Alliance, DC
National Gay and Lesbian Task Force, DC
National Hispanic Council on Aging, DC
National Women's Health Network, DC
Neighbors Against Garbage, NY
New England Patients' Rights Group, Inc., MA
New Hampshire Public Interest Research Group, NH
New Jersey Public Interest Research Group, NJ
New Mexico Coalition Against Domestic Violence, NM
New Mexico Consumer Action, NM
New York City Environmental Justice Alliance, NY
New York Committee for Occupational Safety and Health, NY
New York Public Interest Research Group, NY
New York State Coalition Against Domestic Violence, NY
New York State Tenants and Neighbors Coalition, NY
New York StateWide Senior Action Council, NY
New Yorkers for Accessible Health Coverage, NY
North Carolina Hunger Network, NC
North Carolina Public Interest Research Group, NC
Ohio Citizen Action, OH
Ohio Domestic Violence Network, OH
Oregon Consumer League, OR
Oregonians for Insurance Reform, OR
Oregon State Public Interest Research Group, OR
Patient Information Alliance, NY
Pennsylvania Consumer Council, PA
Pennsylvania Public Interest Research Group, PA
People's Medical Society, PA
Physicians and Patients for Quality Care, NJ
Progressive Tenants Association, Inc., NY
Public Interest Research Group in Michigan, MI
Rhode Island Public Interest Research Group, RI
Safetyforum.com, VA
Senior Action in a Gay Environment/Queens, NY
SmokeFree Educational Services, NY
Statewide Emergency Network for Social and Economic Security, NY
Texas Advocates for Nursing Home Residents, Coastal Bend Unit, TX
Texans for Public Justice, TX
Texas Watch, TX
The Housing Advocates, Inc., OH
Tort Reform Institute, Australia
United Policyholders, CA
Universal Health Care Action Network, OH
USAction, DC
U.S. Public Interest Research Group, DC
Utah Citizens Alliance, UT
Vermont Public Interest Research Group, VT
Washington Citizen Action, WA
Washington Public Interest Research Group, WA
Western New York Committee for Occupational Safety and Health, NY
West Harlem Environmental Action, Inc., NY
West Virginia Citizen Action Group, WV
Woodstock Institute, IL

* Organization listed for identification purposes only.
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