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Statement of Harvey Rosenfield and Todd Foreman
on behalf of Consumer Watchdog
Public Workshop on Proposed Amendments to Proposition 103 Rate Regulations
California Department of Insurance
San Francisco, CA
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Twenty years ago, angry Californians revolted against excessive and destabilizing insurance rates and unjust insurance company practices. Despite an \$80 million campaign waged against it by the insurance industry, Proposition 103 prevailed at the ballot box. One of its most important reforms was the regulation of auto, home, and business insurance rates to guarantee that insurance premiums are fair. Insurance companies are required to file an application when they want to increase or decrease rates and the public is authorized to challenge applications that would lead to excessive or inadequate rates. An equally important reform was the mandate that the Insurance Commissioner, elected by the voters for the first under Proposition 103, enforce these requirements.

The regulatory formula adopted by the first elected Commissioner, John Garamendi, limited insurance companies profits to a reasonable level; rewarded insurance companies that operate efficiently and punished companies that were wasteful and inefficient; prohibited insurance companies from engaging in bookkeeping practices that artificially inflate losses; and limited the amount of money insurers can set aside for their surplus and reserves. Unable to lobby their way out of the regulations, lawyers for the insurance industry challenged them in the courts, like every other element of Proposition 103. The California Supreme Court unanimously upheld the regulations, and the United States Supreme Court subsequently rejected the industry's appeal. The formula produced \$1.2 billion in refunds to California consumers.

When Commissioner Garamendi returned to the post in 2003, Consumer Watchdog and other citizen organizations asked him to update the prior approval formula as well as implement Proposition 103's requirement that auto insurance rates be based primarily upon a motorist's driving record. The Commissioner held four hearings and public workshops on five drafts of the proposed prior approval

regulations, which were the subject of hundreds of pages of criticism from insurance companies opposed to any regulation of their rates or practices. After two years of study, the new regulations were rolled out in 2006. They established uniform standards for determining insurance company profits, efficiency, and claims bookkeeping, making it easier for the Commissioner, the staff of the Department of Insurance, the public, and insurance companies themselves to ensure that rates are fair. The modifications to the prior approval rules became effective in April 2007.

Stringent regulation of insurance rates under the Proposition 103 rules has produced unprecedented savings for Californians: according to a report by the Consumer Federation of America, \$62 billion for motorists alone over the last twenty years. When it comes to insurance, California is the best state in the nation for consumers, that report concludes. According to the insurance industry's own data, California auto insurance premiums rose just 12.9% between 1988 and 2005, while rates nationally increased 50%. In the seventeen years following the passage of Proposition 103, California went from 3rd most expensive state for auto liability premiums in the country to 18th. Californians, who paid 52% more than the national average for auto insurance in 1989, paid just dollars more than the national average (1.8%) in 2005.

As a candidate for the office of Insurance Commissioner in 2006, Mr. Poizner understood the importance of the amendments to the prior approval formula issued by Commissioner Garamendi. He assured the electorate that he would implement and enforce the amendments being finalized by the Garamendi administration.

Steve Poizner for California Insurance Commissioner

10/02/2006 11:59 AM

The screenshot shows a campaign website for Steve Poizner, titled "Steve Poizner Insurance Commissioner 2006". The header includes a navigation menu with links for Home, About Steve, About IC, Issues, Endorsements, News, Multimedia, Resources, Contribute, Volunteer, and Spread the Word. The main content area is titled "Steve Poizner On the Issues" and features a video player with a "Click Here to Watch" button. The video content includes a text block about Proposition 103 and a photo of Steve Poizner. A sidebar on the right contains a "Learn More About Steve" video link and an "In The News" section with a link to a Sacramento Bee article dated 10.02.06.

Indeed, every one of the rate decreases Commissioner Poizner has approved during his term in office was mandated by the Garamendi regulations.

Today's workshop at the California Department of Insurance concerns the second in a series of proposals to undermine the Garamendi regulations and free the insurance industry from the oversight that has saved California hundreds of billions of dollars on their insurance premiums.

This past spring, barely ten months after the Garamendi amendments had taken effect, Commissioner Poizner announced changes to the prior approval system to:

- Allow insurers to earn profits far in excess of what is justified under Proposition 103 by charging excessive rates.
- Permit insurers to game the regulatory system by inflating the projected amount of future claims they can pass through to policyholders.
- Allow insurers to buy unregulated "reinsurance" and then pass all such expenses on to policyholders, while denying consumers the right to challenge the cost of the reinsurance or any conflicts of interest or kickbacks.

These changes – nearly identical to those previously proposed by the insurance industry – were developed behind closed doors. When they were finally revealed, they were presented as an "emergency" by the Commissioner in order to evade the process of careful public scrutiny that is the hallmark of Proposition 103. In lengthy comments submitted to the Department, Consumer Watchdog pointed out that there was no emergency that would justify subverting the public review process; warned that the changes were poorly drafted; and predicted they would lead to rate increases for consumers.

Each of Consumer Watchdog's statements has been proven true. The Office of Administrative Law subsequently rejected the Commissioner's argument that the regulations were needed on an "emergency" basis. The Commissioner forged ahead and filed the proposed amendments without public hearings under a technical exception to the public hearing requirements. The latest changes proposed by the Department implicitly acknowledge that the previous changes were poorly drafted. And insurance companies have happily embraced the changes

to request major rate increases. Indeed, two companies that were recently ordered to decrease rates under the Garamendi regulations have now requested rate increases under Commissioner Poizner's Spring 2008 regulations: Allstate and Mercury.

Increases Requested under Poizner Spring 2008 Amendments (unless stated, pending approval)

<u>Company</u>	<u>Line</u>	<u>Percentage Increase</u>	<u>Dollar Amount</u>
Wawanesa	Auto	5% (Approved)	\$15 million
Hartford Casualty	Auto	6.1% (Approved)	\$11 million
Progressive Choice	Auto	6.49%	\$25 million
21st Century	Auto	5.27%	\$46 million
Mercury	Auto (2 programs)	1.5% & 2%	\$37 million
Allstate	Auto	6.9%	\$100 million
State Farm	Auto	6.9%	\$76 million
Liberty Mutual	Auto (4 programs)	3.24% to 5.33%	\$9.8 million
Safeco	Homeowners	6.9%	\$11.4 million

The latest proposal contains more changes to the complex formula that governs rates. In each instance, the effect is to make it easier for insurance companies to obtain rate increases, and harder for the public to challenge them.

But the plan under consideration today goes far beyond what was hastily adopted last spring. It would specifically authorize insurance companies to charge rates that are determined to be excessive. It would allow insurance companies to avoid the rate application review and approval process required by Proposition 103. The current proposals are a windfall for insurance companies that will force California consumers to pay far more for insurance than they do now. They amount to deregulation of insurance rates at a time when the nation is grappling with the disastrous cost of two decades of deregulation of the financial markets. Were these changes to take effect, the cost to Californians will be in the hundreds of billions of dollars.

California voters expect the Insurance Commissioner they elected to protect their right to fair premiums. Even Insurance Commissioner Quackenbush, whose

fealty to the insurance industry knew no bounds, knew better than to meddle with the prior approval regulations during the six years before he was forced to resign in disgrace.

It took nineteen years for the Proposition 103 rate regulations to withstand the numerous court challenges brought by the insurance industry and evolve to the point where they have made California the best state for insurance consumers in the nation. For twenty years, we at Consumer Watchdog have worked to enforce the law that the voters passed twenty years ago. We will not stand idly by while the law is undermined and its consumer protections are dismantled.

We intend to hold Commissioner Poizner accountable, in the courts of law and in the court of public opinion, for the actions he takes.

Substantive Changes to Prior Approval Regulations

Regulation	Garamendi Regulations (effective April 2007)	Poizner May 2008 “Emergency” Amendments	Poizner November 2008 Proposed Amendments	Rate Impact
<p>Limits on Projection of Future Payouts on Current Claims (§§ 2644.6, 2644.27(f)(7)¹)</p> <p>Controls how insurance companies project what they will pay out in the future on claims that have already been reported to the insurance company.</p>	<p>Required all insurers to calculate based upon an average of their three most recent years of data. Exceptions to the rule are allowed only under very limited circumstances.</p>	<p>No change.</p>	<p>Allows insurer to use essentially any methodology it chooses to support an exception from the rule.</p>	<p>Increased Rates. Allows insurers to inflate their loss and expense projections to increase rates.</p> <p>The CDI recently granted a similar exception to Farmers that increased its homeowners’ premiums by 3.4%, totaling nearly \$30 million annually.</p>
<p>Limits on Projection of Future Premiums and Losses (§§ 2644.7, 2644.27(f)(8)²)</p> <p>This regulation controls how insurance companies project (1) the number and size of future claims and (2) the amount of premiums that they will collect absent a rate change.</p>	<p>Required all insurers to calculate based upon 12 most recent quarters of data. Exceptions to the rule were allowed only under very limited circumstances.</p>	<p>Effectively deregulated this provision. Insurance companies are now allowed to choose between 8, 12, 16, 20, or 24 quarters of data, or to use essentially any methodology it chooses to support an exception from the rule.</p>	<p>No further change.</p>	<p>Increased Rates. Allows companies to use whatever approach they desire that results in the highest rates.</p> <p>Because of this amendment alone, Farmers’ pending application for an auto rate change is 4.0% higher than if submitted under the Garamendi regulations, and Mercury has applied for an auto rate <i>increase</i> that would otherwise be a decrease under the Garamendi regulations.</p>

¹ Renumbered as § 2644.27(f)(8) in November 2008 proposed amendments. All section references are to Title 10 of the California Code of Regulations.

² Renumbered as § 2644.27(f)(9) in November 2008 proposed amendments.

Substantive Changes to Prior Approval Regulations

Regulation	Garamendi Regulations (effective April 2007)	Poizner May 2008 “Emergency” Amendments	Poizner November 2008 Proposed Amendments	Rate Impact
<p>Control on Insurance Company Expenses (§ 2644.12)</p> <p>The regulation rewards efficient companies and penalizes wasteful companies by limiting the amount of expenses that can be passed through to policyholders.</p>	<p>Requires the Commissioner to calculate the industry-wide average expense value by line of insurance. Insurance companies cannot pass through any expenses above that amount.</p>		<p>Increases the amount of expenses that can be passed through and limits the incentives for more efficient companies.</p>	<p>Increased Rates. Half of all insurers will be able to charge higher rates. The least efficient insurers could increase rates by 5% or more.</p>
<p>Regulation of Profit (§ 2644.16)</p> <p>This regulation sets a target maximum after-tax profit.</p>	<p>Sets a maximum rate of return that is indexed to an average of returns on various government bonds, plus an additional 6 percent. As of December 2008, the maximum rate of return that an insurer can build into its rate is 8.47% percent.</p>	<p>Allows the Commissioner to increase the maximum permitted rate of return by an extra 2% based on “financial market conditions.” This change was made without public scrutiny and led insurance companies to request rate increases.</p>	<p>Repeals May 2008 amendment, concluding that the regulation was “unworkable,” and solicits other proposals to allow insurance companies to obtain a higher profit.</p>	<p>Increased Rates. Based solely on a 2% increase to the rate of return under the May 2008 amendment, State Farm seeks to increase its auto rates by 3.3%, or nearly \$81 million a year.</p>

Substantive Changes to Prior Approval Regulations

Regulation	Garamendi Regulations (effective April 2007)	Poizner May 2008 “Emergency” Amendments	Poizner November 2008 Proposed Amendments	Rate Impact
<p>Limits Reinsurance Pass-Through (§2644.25)</p> <p>Reinsurance is secondary insurance purchased by insurance companies to cover excess losses from a catastrophe. The regulation controls whether reinsurance costs can be passed through to consumers, and if so, how much.</p>	<p>Allowed minimal amounts of reinsurance costs to be passed through to policyholders only for earthquake and medical malpractice insurance lines.</p> <p>Contained strict prohibition on allowing insurers to pass through costs of reinsurance purchased from “unauthorized” reinsurers (those not licensed, accredited, or maintaining an approved U.S. Trust).</p> <p>Required mandatory hearings upon request when 30% of an insurers’ proposed rate is attributable to reinsurance costs to determine the reasonableness of the reinsurance costs, and whether some or all of those costs should be allowed to be passed through to policyholders.</p>	<p>Allows insurance companies to pass through reinsurance from unauthorized reinsurance companies in certain circumstances.</p> <p>Limited the scope of consumer challenges to reinsurance costs passed through to policyholders.</p>	<p>No further change.</p>	<p>Increased Rates. Permits dramatic increases in earthquake insurance rates, as much as 40 – 50%. Encourages insurers to buy reinsurance from unregulated companies.</p>

Substantive Changes to Prior Approval Regulations

Regulation	Garamendi Regulations (effective April 2007)	Poizner May 2008 "Emergency" Amendments	Poizner November 2008 Proposed Amendments	Rate Impact
<p>Exception to Ratemaking Formula for Fraud Prevention/Loss Reduction (§ 2644.27(f)(1))</p> <p>Allows an insurance company to request an exception from the standard ratemaking formula for exceptional expenditures on fraud prevention and loss reduction.</p>	<p>Commissioner Garamendi provided exceptions ("variances") as "safety valves" to address rare situations when an insurance company could show that the regulations led to an unreasonable rate. This variance compensated those insurers who incurred extraordinary expenditures for fraud prevention and loss reduction, so long as the insurer could demonstrate reductions equal to or greater than the expenditures.</p>	<p>Standardized granting variances for fraud prevention and loss reduction and removed the requirement that insurers prove actual loss reductions.</p>	<p>No further change.</p>	<p>Increased Rates. Any insurer with certain fraud prevention/loss reduction expenses can double count them in its rates without showing that their expenditures have actually reduced losses.</p> <p>Before May 2008, no such exception had ever been granted. The Department recently granted such an exception to Farmers, increasing its homeowners' rates. Mercury, Farmers, Auto Club, and Allstate have all requested the variance under the new regulations.</p>

Proposed Changes to Prior Approval Procedures

Regulation	Garamendi Regulations (effective April 2007)	Poizner May 2008 "Emergency" Amendments	Poizner November 2008 Proposed Amendments	Rate Impact
<p>Delayed Implementation of Rate Changes (§ 2644.29)</p> <p>Proposition 103 requires that insurance rates are appropriate at all times to protect against price-gouging on one hand, and insolvency on the other. The regulations establish a formula to determine whether a rate is excessive or inadequate.</p> <p>This new proposed regulation will violate the requirement that no rate remain in effect that is excessive or inadequate.</p>	<p>Did not exist.</p>	<p>N/A</p>	<p>Seeks to allow insurers to implement rate changes greater than 15% over a period of time up to two years, rather than immediately as required by the statute.</p>	<p>Excessive or Inadequate Rates.</p> <p>By not implementing a required <i>decrease</i> immediately, this change would allow insurers to charge rates that the Commissioner has already determined are excessive.</p> <p><u>Example:</u> Commissioner Poizner's highly touted \$500 million in annual rate reductions for Allstate homeowner's and auto lines, which were both decided using the Garamendi regulations, could have been implemented over two years instead of immediately.</p> <p>For rate increases, failure to implement the minimum required rate could leave insurance companies in danger of insolvency.</p>

Proposed Changes to Prior Approval Procedures

Regulation	Garamendi Regulations (effective April 2007)	Poizner May 2008 "Emergency" Amendments	Poizner November 2008 Proposed Amendments	Rate Impact
<p>Change in Regulation of Rate Decreases (§ 2644.51)</p> <p>Proposition 103 requires insurance companies seeking to change their rates to file an application with the Commissioner, who must review and approve rates prior to their use. Members of the public have the right to review and challenge the applications through a hearing process.</p> <p>This new proposed regulation would violate the statutory requirement that no rate remain in effect that is excessive or inadequate, and the public participation requirements of Proposition 103.</p>	<p>Did not exist.</p>	<p>N/A</p>	<p>Would eliminate statutory requirement that Department review and Commissioner approve applications seeking a decrease; allows all such applications to be approved without the necessary scrutiny by the Commissioner or the public.</p>	<p>Excessive or Inadequate Rates.</p> <p>Would allow insurers to continue to charge excessive rates by seeking a smaller decrease than is required by the law. Would also allow insurers to evade solvency protections under Proposition 103. And would allow insurers to destabilize the market and undermine competition by charging inadequate rates.</p> <p><u>Example:</u> This year, Allstate was ordered to lower its auto and homeowners insurance rates by \$250 million each. Had this proposed change been in effect, Allstate could have been allowed to automatically implement decreases of \$110 million and \$80 million respectively without any scrutiny.</p>