Consumer Watchdog

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July 29, 2008

The Honorable Nancy Pelosi
Speaker
The United States House of Representatives
H-232, U.S. Capitol Building
Washington, D.C. 20515

Dear Madam Speaker:

As you know, over the last twenty years California consumers have been protected from insurance company rate gouging, illegal surcharges and other abusive practices by Proposition 103, which enacted the toughest regulation of insurance companies of any state in the nation.

In its present form, H.R. 5840 (Rep. Paul Kanjorski, D-PA) directly threatens the stringent consumer protections enacted by California and similar statutes in other states because language in the bill goes far beyond "information gathering," granting unelected officials in the federal bureaucracy the explicit authority to overturn state consumer protection laws. Despite its unprecedented scope and vague terms, the legislation is scheduled to go directly to the floor, without a full committee hearing, this week.

At a time when the economy is reeling from scandals in the financial markets made possible by nearly a decade of misguided federal policy, the last thing Congress should do is decree a radical departure from a decades-long policy of deference to state insurance regulation. I write to ask you to protect consumers in California and other states by requiring this bill to follow the normal committee process so that the implications of the bill can be fully investigated and all parties' views can be considered.

<u>H.R. 5840: Information-Gathering Becomes Federal Deregulation By Administrative Fiat</u>

Supporters of H.R. 5840 say the federal government should be allowed to collect data on the national insurance marketplace. We wholeheartedly agree. And while we believe existing agencies are empowered to collect such information, or should be (for example, by lifting the congressional exemption of the industry from Federal Trade Commission oversight), the creation of an "Office of Insurance Information" (OII) within the federal government to collect such information is certainly reasonable.

Most of H.R. 5840 has nothing to do with information gathering, however. Rather, it accords the Director of the Office of Insurance Information - a person appointed by another political appointee, the Secretary of the Treasury – the authority to unilaterally override state laws which, in the Director's view, are "inconsistent with Federal policy on international insurance matters."

Of course, there is no "Federal policy" on insurance matters, international or otherwise. The only time Congress has comprehensively addressed insurance matters was back in 1945, when it enacted the McCarran-Ferguson Act, which relieved the insurance industry of the obligation to obey the federal antitrust laws by *allocating responsibility for insurance policy to the states*. For the last several years, various factions within the insurance industry, and the Bush Administration, have asked Congress to usurp state laws and require federal regulation of insurance companies. But Congress has never adopted such a policy.[1]

Detouring Congress altogether, H.R. 5840 hands the job of developing a federal policy to the Director of the OII, who will single-handedly "establish[]" the policy. This will occur by way of "agreements" negotiated by the federal government with foreign countries or even foreign "authorities." In other words, the content of the agreements, which are negotiated behind closed doors, becomes the federal insurance policy. The agreement between the United States and the foreign country determines the fate of the state laws. If the OII Director believes that a state "measure" – any law, regulation or other rule applicable to insurance companies – is "inconsistent" with the agreement, the OII may preempt the state law.

The legislation states that the "scope" of the preemption is determined by comparing the impact of the state law on two insurance companies. If the Director of OII determines that a state law "treats" a single insurance company from the foreign country "more or less favorably" than it "treats" a United States-based insurance company, the state law is invalidated to that extent. The meaning of these terms is unknown. Insurance law and

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[1] It is clear that many of H.R. 5840's supporters view the bill as a step toward full federal regulation. The bill's co-author, Rep. Ed Royce (R-CA), has unabashedly described H.R. 5840 as a vehicle to override the laws his constituents enacted when they passed Proposition 103: "I believe it would move us one step closer to establishing an optional federal charter for insurance which would provide a much needed regulatory alternative to the tangled bureaucratic web of state-based insurance regulators." The Department of the Treasury under the Bush Administration has long sought to deregulate insurance companies under the guise of transferring jurisdiction from states like California, where rates and practices are stringently controlled, to the federal government. In its "Blueprint for a Modernized Financial Regulatory Structure," the Treasury Department explained that the "Federal Office of Insurance Oversight within Treasury [would] establish a federal presence in insurance for international and regulatory issues," describing that as an "intermediate step" to allowing insurance companies to evade state regulation altogether.

regulation must often be applied differently based on the different circumstances of individual insurance companies, as is discussed below. H.R. 5840's broad preemption language puts every state protection against insurance abuses – from rate regulation to disaster response, claims handling to fraud prevention – at risk.

Why would Congress be concerned about how insurance companies in foreign countries are treated? And why would Congress authorize preemption of American laws on behalf of foreign insurance companies? Though we have been unable to obtain a satisfactory justification, the answer is plain. **Once a state law is preempted by the OII, American insurance companies will no longer have to obey that state law either.**

H.R. 5840 effectively deregulates insurance companies that have the capability to lobby foreign officials for "agreements" that will then supersede those state laws that the OII believes are inconsistent.

Thus, H.R. 5840 reverses more than sixty years of state regulation, and does so in a manner that does not comport with Congress's obligation to the citizens of the several states. Instead of Congress conducting a thorough and open debate on the advantages of state vs. federal regulation, the legislation confers authority upon a federal political appointee to determine which state laws survive, on a piecemeal, ad hoc and potentially inconsistent basis. Moreover, while the Director of the OII can invalidate state laws, the legislation expressly forbids the Director from establishing any new protections to take their place. (Section 313(j).) That is why we say that H.R. 5840 is complete deregulation.

Impact on California's Insurance Laws

Supporters of the legislation offer little explanation of which state insurance laws the OII may use its authority to preempt. However, consumers in every state will feel the impact if state insurance regulation is preempted under the guise of international agreements, and Californians will be especially hard hit. California voters approved Proposition 103 in 1988. Proposition 103 imposed stringent regulation of the insurance industry, required an ongoing 20% discount for good drivers, required companies to base auto insurance premiums primarily on driving record rather than ZIP Code and prohibited anticompetitive practices that continue to be allowed in most other states to this day.

An April 2008 state-by-state study of auto insurance regulation, by the Consumer Federation of America, found that California drivers have saved $62 billion since Prop 103's passage. The Federation named California, under Proposition 103, one of the most competitive and profitable markets in the country, with the slowest-growing automobile insurance premiums in the nation.

Insurers have continuously and aggressively resisted Proposition 103's requirements before the California Department of Insurance, in state and federal courts and in the state legislature. They want to keep the billions of dollars in excessive rates that they are required to forego under Proposition 103; they do not want to have to comply with

prohibitions and restrictions on their underwriting and marketing practices; they do not wish to be subject to lawsuits in state courts for violation of state laws.

Under Proposition 103, regulation of rates is accomplished by a formula that takes into account each insurance company's unique characteristics. The single largest insurer in California, Swiss-owned Zurich Insurance Group, which controls 10% of the state's market and sold about $6 billion of insurance in California alone in 2007, was recently ordered to decrease its homeowners insurance rates by the California Insurance Commissioner acting under the authority of Proposition 103. Its policyholders saved $171 million. No wonder that Zurich supports H.R. 5840.

Fireman's Fund recently agreed to a settlement of an administrative proceeding before the California Department of Insurance, conducted under the authority of Proposition 103, that required the company to lower its homeowners insurance rates by 18%. Fireman's Fund would certainly not have agreed to the rate decrease – which saved policyholders $35 million – if it could instead choose to write insurance through its foreign parent company (Allianz of Germany) and lobby officials at the U.S. Treasury to override the California Insurance Commissioner's authority to set individual companies' rates by claiming that a lesser rate reduction received by another insurer constituted unequal treatment.

The mere threat of preemption under H.R. 5840 will undermine the Commissioner's authority. The California Insurance Commissioner is the chief arbiter of companies' rates and premiums; to hold the Commissioner accountable, the voters made it an elective office. H.R. 5840 would permit insurers to hang the threat of federal pre-emption over the Commissioner's head any time the Commissioner is required to rule on their rates and practices. Preemption will also become a defense in California courts, which under Proposition 103 are authorized to entertain civil lawsuits challenging violations of its provisions. And if the Commissioner or a state court enforces state consumer protection laws and the insurer goes to the U.S. Treasury for relief, then the meaning and scope of California's statutes will be in the hands of federal appointees and federal courts rather than the California Department of Insurance and the state courts that have enforced and upheld Prop 103 for twenty years.

<u>H.R. 5840's Procedures for Challenging a Preemption Decision Provide Illusory Protection</u>

Supporters of the legislation claim that the bill contains procedures that will help ensure that the OII's preemption decisions are proper. We strongly believe they are largely illusory.

The bill requires the Secretary of the Treasury to stay the preemption order if the Secretary determines that the state law is "necessary for prudential reasons," which include the "protection of policyholders and policy claimants," or if preemption will result in a "gap or void" in "market conduct regulation" of an insurance company. But these broad generalizations are susceptible to any definition. The ideology of political

appointees is unlikely to vary between the Secretary and the person the Secretary appointed to OII; once a decision to preempt is made, it is likely that the Secretary will be in support. Nor is the possible presence of a consumer advocate on an "Advisory Group" dominated by industry likely to deter federal appointees – after all, the group is appointed by the Secretary, is merely "advisory" and has no authority. Finally, the right to seek judicial review of an agency action affords no protection. Under the Administrative Procedures Act, which applies here, the courts look principally to whether the statute authorizes the agency's action. Once the court determines that the agency had legal authority to act, the agency's decisions are treated with substantial deference. Put simply, no court will invalidate an agency's decision unless it is clearly in violation of this statute. As we have explained, H.R. 5840 is so broadly worded that there is virtually no constraint on a preemption decision.

This Is the Last Thing Congress Needs to Do Now

These are tough times for Americans who work hard and play by the rules. The federal government's economic and regulatory policies – beginning with the deregulation of the financial sector in 1999 through the *Gramm-Leach-Bliley Financial Services Modernization Act* and continuing through the Bush Administration's enthusiastic support for speculation and arcane financial instruments – have crippled our economy and jeopardized the financial security of our people. In this context, it is bewildering that Congress would even contemplate unleashing the insurance industry on beleaguered consumers. With all that must be done now to rescue our financial system and repair the damage, the last thing Congress needs to do is authorize the de facto deregulation of insurance rates, premiums and practices. There is no justification for the hasty passage of this legislation.

Thank you for your consideration of our views.

Sincerely,

Harvey Rosenfield

Douglas Heller