



July 23, 2010

Gov. Arnold Schwarzenegger  
State Capitol Building  
Sacramento, CA 95814

Via facsimile, (916) 445-4633

Dear Gov. Schwarzenegger,

You recently came out in opposition to giving state insurance regulators the power to stop unreasonable health insurance premium hikes before they take effect, as the Department of Insurance does with property/casualty insurance rates. Instead, you called on California to largely wait for the federal government to identify unreasonable premiums, although it has no power to stop them, and to prevent state regulators from barring even unreasonable, unjustified and inaccurate premium increases. We write to urge you to change course based on irrefutable evidence about the success of property casualty insurance regulation in California over the last two decades under voter-approved Proposition 103.

You criticize prior approval rate regulation as a “blunt instrument.” Yet rate regulation, including the state’s power to reject and revise insurer rate changes, is by far the most effective way to protect consumers while preserving a competitive and profitable health insurance market.

Far from being a blunt instrument, Proposition 103’s auto insurance regulation, the strongest in the nation, is a sharp scalpel that saved tens of billions of dollars for consumers and has benefited the state economy at a modest cost. A 2008 state-by-state study of auto insurance rates by the Consumer Federation of America found that California rate regulation stands out as a model of consumer protection:

- California drivers have saved more than \$61.8 billion in auto insurance rates since enacting the strongest regulation in the nation, an average of \$1670 per Californian;
- California is first among all states in holding down insurance premiums, with a 12.9 percent increase from 1989 to 2006 compared to an average national increase of 50 percent;
- California is the fourth most competitive auto insurance market in the nation; Completely unregulated Illinois ranked 44<sup>th</sup>.
- Our consumer group alone has intervened to stop \$1.72 billion in unnecessary premium hikes between 2003 and 2009.

The full report compares insurance regulatory systems nationally and finds that consumer prices increase as regulation gets weaker. It is available at

[http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/state\\_auto\\_insurance\\_report.pdf](http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/state_auto_insurance_report.pdf)

The report also highlights California's state of the art prior approval regulations that:

- Require insurers to be transparent about how rates are developed;
- Prohibit companies from passing on excessive costs including unjustifiable expenses, fines, and excessive executive salaries;
- Set standards to test the assumptions insurers make in setting rates; and
- Fund consumers' participation in the ratemaking process if they make a substantial contribution.

All of these benefits to consumers and ultimately the state come at a modest price, which is covered by insurer payments. Of the \$210 million in the California Department of Insurance 2009-2010 budget, \$54 million covered the entire cost of regulating all lines of insurance companies and producers (agents/brokers). Among the expenditures was review of about 8,350 property/casualty insurance company filings (based on 2008 data). The Department estimates that its rate reviews cost about \$14 million yearly, for all filings of all of the state's 7,000 or more property and casualty insurers, excluding consumer services and legal actions.

In your July 8 letter to U.S Health and Human Services Secretary Kathleen Sebelius, you state that "rate regulation is a blunt instrument that does nothing to contain the underlying cost drivers in the system."

Yet rate regulation does offer provable cost containment, including the engagement of insurers in controlling exterior costs. California auto insurers have more aggressively fought against fraud and supported effective auto and traffic safety to help keep down insurance rates. Prior to Proposition 103, auto insurance rates were set on a "cost plus" basis, which allowed insurers to pass on any costs directly to consumers, and insurers had little or no interest in cost containment. Now, Proposition 103 regulations reward insurers for efficiency, and containment of outside costs is an ordinary part of doing business.

The state's health insurers, in the absence of rate regulation, would continue to use cost-plus pricing, with no impetus hold down exterior health costs or bloated executive compensation.

In describing your substitute legislation sent to state lawmakers who are backing rate regulation legislation, you claim that you go above and beyond federal law with a requirement that insurers seek an "independent" actuarial review of rate increases. Yet you would allow the insurers to choose and hire the actuaries. Such reviewers would be economic vassals of the insurers—the opposite of independent.

Hiring costly private actuaries to review every rate filing would, in itself, become an "underlying cost driver." With rate regulation, insurance regulators can identify rates that require additional review and use in-house staff for most examinations.

Under your proposal, state regulators could not examine a rate increase unless it was declared "unreasonable" under federal law, a term not yet defined by federal regulators, or an undefined "outlier." There is no mechanism for rejecting even excessive rates. Why would or should the state of California cede power to federal officials who acknowledge today that they don't have the resources, capacity or legal authority to determine whether a rate is or is not reasonable? In addition, the health reform law clearly sees states as the leaders in identifying unreasonable rates and bringing them to the attention of HHS.

You state that the federal requirement that insurance companies issue rebates to consumers if they spend less than 80% to 85% of premium dollars on actual health care will control premiums. This is not true because:

- Insurers are intensely lobbying the administration and the National Association of Insurance Commissioners to ensure that definitions of what constitute health care and health quality improvements are as broad and vague as possible, while the amount of their premium income is made to appear smaller by deduction of unrelated taxes.
- Insurers will have no reason to control underlying cost drivers if paying more to doctors and hospitals allows them to charge a higher premium and keep a higher dollar amount, while still staying within the 80% to 85% limit. In fact they will have an incentive to raise costs to raise their 15% to 20% take. For example, wouldn't your own Hollywood agent seek to get you top dollar, partially to receive a bigger commission?

You note that you would require insurers to make public more information about their rates. Yet under your proposal, insurers would have substantial control over the information that they make public because you would allow them to withhold any information that they consider competitive or proprietary, subject only to the approval of the director of the DMHC, who is your appointee.

Your administration has increasingly sided with health insurers in recent years, to the detriment of consumers. We ask that you reconsider your course based on the fact that by 2014 every American will be required to have a health insurance policy. This requires new duties from the health insurers and the state to guarantee that the premiums paid by individuals and businesses are reasonable.

Yet your legislative proposal does not allow regulators to take any action to block or withdraw rates found to be both unreasonable *and* unjustified, or even inaccurate. The findings may only be posted on a website.

From the language of your proposal:

*Section 1358.03 (b)*

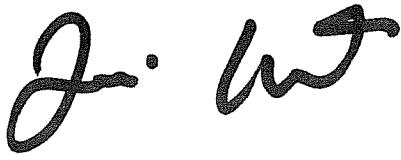
*If the department finds that any rates that are considered unreasonable are not justified, or the rate filing contains inaccurate information, **the department shall post its findings on its Internet Website.*** (emphasis added)

Notwithstanding the more than \$1.3 million in political contributions from the health insurance industry that you have received while in office, you have shown the capacity to do what is in California's best interests despite your political allegiances. We ask that you do so here and reconsider signing a prior approval system for health insurance rates that follows California's success with property casualty insurance regulation.

Your legislative proposal hews closely to insurance industry lobbying positions, and we ask that you withdraw it based on the evidence in this letter and the needs of beleaguered Californians who simply cannot afford to keep paying outrageous health insurance premium increases. With all due respect, Governor, they need and deserve more than a fig leaf protecting the status quo for the health insurance industry, which is what your proposal amounts to.

We ask that you withdraw your substitute legislation and support strong prior review of rates for an industry that has proven its inability to curb rates on its own.

Sincerely,

A handwritten signature in black ink, appearing to read "J. Court". The letters are stylized and cursive.

Jamie Court

A handwritten signature in black ink, appearing to read "Judy Dugan". The signature is written in a cursive style with a long horizontal flourish at the end.

Judy Dugan