

**Presentation of Birny Birnbaum
Consumer Liaison Meeting
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Making the Case for State Insurance Regulation in 2003

In 2002, the NAIC unintentionally made a case for federal insurance regulation. We are asking that 2003 be the year the NAIC makes the case for state insurance regulation.

State insurance regulators need to make a case for state insurance regulation. That case will not be made by trying to make state insurance regulation as efficient as federal regulation would be because there is no way that state insurance regulation can be as efficient as federal regulation.

Which makes the whole notion of the interstate compact as the prime effort of the NAIC to thwart federal regulation a misguided effort. All the compact will do, and has done, is point out how much more efficient federal regulation can be. Moreover, the compact is not an extension of state regulation, but federal regulation light. It garners no support for state insurance regulation from industry, since the life folks still push for a federal charter. Bottom line, the interstate compact is not making the case for state regulation of insurance and it is probably helping make the case for federal regulation because the compact is vividly pointing out how much less efficient state regulation is.

The case for state regulation will not be made on the basis of efficiency. And it shouldn't be. The issue that should be emphasized is effectiveness. Which is more effective in protecting consumers while promoting competitive markets? This is where state regulators should be putting your efforts -- state regulation can be more effective than federal regulation at protecting consumers no matter what the federal regulation is. And the competitive advantage of state insurance regulation is the closeness of state regulators to the market. In theory, state insurance regulation should have an insurmountable advantage over federal insurance regulation in identifying market problems and responding quickly to those problems. States also offer laboratories of innovation. The NAIC can make the case for state regulation of insurance by demonstrating / developing states' capacities for identifying market problems quickly (market analysis), for sharing that information with other states quickly (market conduct regulation modernization and minimum standards) and ensuring rapid dissemination of best practices (adoption of best practices by NAIC and quick implementation by states). This is the potential competitive advantage which state regulation has over federal regulation -- efficiency and **effectiveness** of market conduct regulation. Consequently, the way for the NAIC to make the case for state insurance regulation is to play up its strong suit and develop the tools necessary to accomplish the market conduct modernization.

It is also necessary for the NAIC to demonstrate effectiveness of state insurance regulation by actually developing and adopting measures responding to demonstrable market problems. More on that later.

To focus on efficiency is to embrace the best attribute of federal regulation. The proposed compact emphasizes the worst attributes of state regulation -- the lack of efficiency and uniformity -- while de-emphasizing the best attributes -- the ability of some states to be at the cutting edge of consumer protection provisions in policy forms. Instead of emphasizing the role of states in developing ever more impressive consumer protections, the compact eliminates the role of individual states and creates disincentives for states to pursue state of the art consumer protection activities. A compact that emphasized the best attributes of state regulation -- that some states are on the cutting edge of consumer protection -- would make the product standards a function of the actions of a few cutting edge states instead of the federalized approach envisioned that will guarantee middling protections at best.

It is clear that the case for state regulation of insurance must rest on the superior effectiveness of state-based market conduct regulatory activities. Unfortunately, state regulators have little to point to in this regard. Most, if not all, of the major market conduct problems have surfaced because of consumer / media / trial lawyer initiatives, not market conduct examinations. There are no basic market regulation minimum standards. There is relatively little market analysis. There are no institutional mechanisms for sharing emerging market conduct issues. And, worst, there is no track record at the NAIC of getting out in front of a problem and developing pro consumer solutions.

The proposed regulatory model guiding much NAIC effort over the past few years -- lessen front-end regulation and beef up back end regulation. First, in terms of efficiency, clearly better to stop a bad product from getting into the market than trying to get restitution for consumers after fact. Second, no evidence that reliance on market conduct is effective. Third, there is no market conduct approach to rely on, since there is no uniformity of resources or approaches or existence of mc regulatory activity among the states.

We will call on the NAIC to make 2003 the year that the NAIC makes the case for state insurance regulation. We ask you to focus on the areas where you have -- or should have -- a competitive advantage in the effectiveness in protecting insurance consumers: the identification of market conduct problems, the prevention of market conduct problems and the remediation of market conduct problems.

And the evidence will be how the NAIC addresses a number of issues:

Will the NAIC accomplish market regulation modernization that includes:

- Identify the reasons for regulators' failures to identify mc problems in the past
- Establishing minimum resource requirements for state market regulation efforts
- Minimum data collection for market analysis – including underwriting guidelines, claims settlement handbooks and market performance data
- Develop market analysis tools to identify market conduct problems and focus market regulation resources
- Institutional mechanisms for rapid adoption and dissemination of best practice market conduct responses.

Will the feet dragging on small face policies continue, as it has for decades, or will the NAIC acknowledge and address small face market problems? Will 2003 be the year the NAIC addresses problems with excessive premiums in aggregate and for certain consumers, in particular? Will the NAIC collect and make public basic premium and claim information on the small face market? How long will the NAIC continue to have the useless industrial life category in the Annual Statement before replacing it with a small face definition?

Will the NAIC stake out a position on insurance credit scoring and risk classification issues generally? Will the NAIC take the position that risk classification is too important a public policy issue to be left to insurers and market forces?

Will the NAIC get serious about researching the effectiveness of consumer disclosures in protecting consumers?

Will the NAIC address the single digit loss ratios in mortgage guaranty insurance?

Will the NAIC try to develop some credibility on the need for regulation of debt cancellation products by addressing the problems of single premium credit insurance in areas other than mortgage loans? Will the NAIC prod its member states to do something about single digit credit unemployment and credit property loss ratios?

Will the NAIC write an amicus brief in a lawsuit on behalf of consumers instead of always on behalf of insurance companies wanting to avoid their market conduct failures?

We hope that 2003 is the year that the NAIC and its supporters put to rest any question about whether consumers will be better served by state or federal insurance regulation.

Bio for Birny Birnbaum

Birny Birnbaum is a consulting economist whose work focuses on community development, economic development and insurance 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, 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, insurance credit scoring, insurance redlining and credit insurance abuses for CEJ and other organizations. Birny serves on the National Association of Insurance Commissioners Consumer Board of Trustees.

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 on a variety of topics. His particular areas of insurance expertise include:

- Homeowners and Automobile Insurance Availability and Affordability
- Evaluation of Underwriting and Rating Factors
- Data Strategy, Collection and Analysis
- Analysis of Insurance Markets and Availability
- Review of Rate Filings and Rate Analysis
- Loss Prevention/Cost Drivers
- Regulatory Policy and Implementation

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 issues. 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.