



COMPETITIVE ENTERPRISE INSTITUTE

September 24, 2007

Kevin McCarty
Florida Superintendent of Insurance
Chair, NAIC Property and Casualty Insurance (C) Committee
200 East Gaines Street
Tallahassee, Florida 32399-0305

Re: Personal Lines Regulatory Framework

Dear Chairman McCarty and Members of the Property and Casualty Insurance (C) Committee:

I write to you on the behalf of the Competitive Enterprise Institute, a Washington, D.C.-based think tank devoted to classical liberal economic policies. We advocate these policies because we believe in freedom for both individuals and business enterprises. We believe that the economic deregulation we advocate will benefit the economy and the American people as a whole.

We commend the C Committee's thoughtful, hard work on a difficult issue and we believe that the Committee's report focuses much needed attention on the entire issue of rate regulation in personal lines. The report represents an important step towards a recognition of the destructive consequences of rate regulation.

We do, however, wish to raise some concerns about the report. In particular, however, we have grave concerns about several aspects of both the proposed model law and the process used to develop it. Although numerous sections of the law are of interest to us, we wish to use this letter to highlight three particular major concerns:

- We dispute the Committee's effort to distinguish between "rate regulation" and "price control."
- The proposed model law envisions a continued system of rate regulation and proposes to protect consumers from "excessive" rates and other supposedly bad practices. We believe that this amounts to continued price control.
- While we applaud the Committee's willingness to consider the elimination of price controls in certain cases, we strongly question the need for the proposed "electronic insurance exchange." Such mechanisms are already widespread and having the government run one seems unlikely to benefit consumers or unleash market forces.

Rate Regulation and Price Control are (Often) the Same Thing.

The report as written spends 330 self-contradictory words attempting to distinguish between rate regulation and price control. In fact, no meaningful difference exists. As the committee reports, only “one state [Massachusetts]. . . promulgates the rates that insurers must charge,” and then only for auto insurance. But this does not mean that the “impression that most or all states tell insurers what they can charge” is wrong as the Committee strongly implies it is.¹ In fact, most states do play a major role in dictating the prices insurers charge and the system can rightly be called one of price control.

A history of “price controls” as economists understand them does *not* typically involve the directly government made prices that Massachusetts imposes on automobile insurance rates. Price control in the United States, in fact, has rarely involved efforts to disable the price mechanism altogether. Instead, government has used various mechanisms—many of them quite similar to those involved in insurance regulation—to discipline prices. Economy-wide price control efforts during World War II for example, sought to avoid full-scale “repression of the market” and, in fact, often operated under a “file and use” framework.² The name of the mechanism used implement this price-regulation regime--“General Maximum Price Order”—itself implies something less than total control. More limited price and wage controls during the Vietnam and Korean wars—mostly limited to war-related industries--likewise, allowed a certain degree of pricing freedom. In fact, one must go back to the Colonial period to find cases where prices set by government fiat alone (like those in Massachusetts) were the norm.³ Even Illinois, which has no rate regulatory law as such for property and casualty insurance, does maintain a form of price control by mandating actuarial adequacy in insurance rates and by mandating that auto insurers charge the same rates to identically situated consumers throughout the city of Chicago.⁴ Price controls, as economists understand and historians have spoken about them, are the norm in American insurance markets. Not all states, of course, regulate to the extent that one could consider the system one of “price control” but many do.

The Model Legislation Envisions Continued Price Controls

The lack of government rate making, in other words, does not mean that price controls do not exist. The committee itself recognizes that the letter of the regulatory law, in any case, do not always determine the way that insurers and consumers actually find themselves touched by regulation. In particular, it writes:

In many jurisdictions the regulator has some measure of discretion as to how the regulatory framework is administered. For example, a file and use system can be administered – or treated by insurers - in a way that is not very different from a

¹ NAIC Committee C. “Personal Lines Regulatory Framework,” August 28, 2007. 6-7

² Hugh Rockoff. *Drastic Measures: A History of Wage and Price Controls in the United States*, London: Cambridge University Press, 1984, 86-87.

³ Ibid 18-19.

⁴ Stephen P. D’Arcy. “Insurance Price Deregulation: The Illinois Experience.” In J. David Cummins (ed.) *Deregulating Property-Liability Insurance: Restoring Competition and Increasing Market Efficiency*, Washington, D.C.: Brookings, 2004. 248-85.

prior approval system.⁵

For example, Committee C's own chair surely knows that his home state—Florida—sells home owners' insurance through an agency of state government that operates as the Citizens Property Insurance Corporation. Florida's legislature and governor, furthermore, have banned Citizens from raising its rates until 2009, set those rates below market levels in coastal areas, and allowed consumers to purchase insurance from Citizens if they receive one quote more than 15 percent above Citizens' price. Coupled with actuarial adequacy standards (which create a price floor), this allows "competition" only within a narrow band between these standards and Citizens-rates - plus-an-additional-fifteen-percent.⁶ For all intents and purposes, therefore, Florida's system amounts to a price control regime although government does not directly make rates.

Any political system of rate regulation—however developed—will raise the possibility of price controls. The model legislation seems to create enormous room for the imposition of price controls for nakedly political reasons. For example, section 4 of the model legislation, allows an insurance commissioner to declare any market "uncompetitive" if a "reasonable degree of competition" does not exist. The proposed tests for determining the lack of competition include "unreasonably high" profit levels "for companies generally in the market segment." This standard suggests a strong bias towards rate regulation. While insurance contracts must, of course, adhere to standards of conscionability, large short-term profits will likely to bring in new firms and make a market more competitive. Rather than recognizing this fact, however, the Committee has proposed a law that suggests political rate regulation in cases where a market is, in fact, just on the verge of becoming more competitive.

We have similar concerns about language relating to "unfairly discriminatory rates" (Section 5(A)(4)(a)); the definition of excessive rates (5)(A)(1), the enumeration of "basic factors in setting rates" (5)(A)(4)(a). Coupled with the "file and use/use and file" system outlined in section 6, this amounts to a system that allows a high degree of price-setting through political—rather than market—processes.

We urge the Committee to reconsider this model legislation as written and eliminate the notion of a rate regulatory mechanism altogether. At minimum, it should eliminate the sections noted above.

Government Should not run an Electronic Insurance Exchange

The proposed standards also envision the creation of government-run "electronic insurance exchanges" free of most types of rate regulation. According to the Committee "applicants tend not to search the marketplace because of lack of transparency and the

⁵ NAIC Committee C. "Personal Lines Regulatory Framework," August 28, 2007. 8.

⁶ Although we believe that society should eventually work to find private mechanisms to enforce standards of actuarial adequacy, we do recognize that they are a necessary part of the insurance business as it exists. We do not suggest their repeal in the short or medium term.

time consuming process that must be endured if one is to seek multiple quotes.” We applaud the willingness to free the market from price controls but CEI questions the wisdom or necessity of having states set up such exchanges as a means of promoting transparency.

A government-run electronic exchange is hardly necessary. Such exchanges are already widespread. Websites such as netquote.com, kanetix.com, insurance.com, lowestcarquotes.com, insure.com (to name only the first five relevant results of a Google search for “insurance price comparison”) allow comparison of insurance quotes for automobile and/or homeowners’ insurance. One of the nation’s largest automobile insurers, furthermore, widely markets its own willingness to provide quotes from its competitors when a potential customer calls. All good independent insurance agents, likewise, do extensive comparison shopping on behalf of their customers. Consumers, in short, already have a robust ability to comparison shop and the level of competition between various providers of insurance comparisons seems certain to bring innovations.

A government-run insurance exchange—presumably supported through tax revenues—significantly reduces the need for non-direct sellers of insurance to deal with agents or rely on them for new business. It also threatens the business of existing comparison websites and what may be the most important business advantage that independent agents have. In other words, it would largely serve as a subsidy for insurers.

Although we support the Committee’s call for pricing freedom, we believe that the establishment of such an “exchange” would undermine an already vibrant market for insurance price comparison shopping and serve to pad the bottom line of insurance companies without bringing any new benefits to consumers.

Concluding Thoughts

The Committee has worked hard and starts from admirable first principles. The proposed personal lines regulatory framework, however, does not significantly change the existing system of government-run price controls. A system that benefits consumers, creates wealth, and increases personal freedom will require much more extensive deregulation than the Committee has envisioned.

In short, CEI believes that rate regulations will work best when administered via market mechanisms and guarantee funds’ own standards for actuarial adequacy. The standards proposed, however, envision a continuation of the current system of government price controls.

Respectfully Submitted,

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