Questions from Senator Specter

The McCarran-Ferguson Act: Implications of Repealing the Insurers' Antitrust Exemption
June 20, 2006

For Hunter (CFA):

You testified that California's reforms drastically reduced the cost of insurance for consumers over time. Please describe the regulatory and antitrust reforms implemented after the adoption of Proposition 103 and discuss how the various reforms have influenced prices.

Response:

Proposition 103 dramatically altered California's regulatory system from one with virtually no regulation that allowed rating bureaus to exercise cartel-like rate setting authority to a system with significant state antitrust restrictions and a tough regulatory regime that reinforces competition. For example, insurers must seek prior approval of insurance rates and forms from the Insurance Commissioner. As a result, California insurance prices have risen at a significantly lower rate than the national averages since Proposition 103 became law.

Proposition 103 incorporated all of the changes needed to spur meaningful, vigorous competition. For example, it imposed significant antitrust restrictions on the state insurance industry. It also allowed banks to sell insurance and permitted group sales well before other states did. Proposition 103 also spurred greater agent competition by allowing agents to offer rate rebates.

Further, unlike the weak enforcement efforts in most states that require prior rate approval, Proposition 103 requires and adequately funds full regulatory oversight. This assures that consumers are protected and that competition is effective. California regulations are exemplary – by far the most effective state insurance regulations. They are completely transparent, allowing insurers, agents, brokers and consumers to understand what is expected. These regulations disallow excessive costs, such as excessive expenses, fines, bad-faith lawsuit costs, and excessive executive salary costs. They test insurer assumptions with state standards. The required data elements assist insurers in obtaining information on competitors, which improves their ability to compete.

The strong incentives for driver safety built into Proposition 103 play a significant role in reducing the cost of insurance. Consumers with a clean driving record receive a 20 percent discount. They also have the right to buy insurance from the company of their choice through Proposition 103's "Good Driver Protections."

Proposition 103 was a shot across the bow of the insurance industry. Prior to 103, the industry saw itself as a "pass-through" operation, adding up anticipated losses and expenses, no matter how inefficient, and including desired profits on top of these costs. So long as they kept costs near their generous loss projections, they had what amounted to a "cost-plus" system. In California, that "cost-plus" approach was rejected under Proposition 103 and costs were tested by efficiency standards and other methods.

As CFA's in-depth study of regulation by the states revealed,[1] (attached) California's regulatory transformation -- to rely on both maximum regulation and competition -- has produced remarkable results for auto insurance consumers and for the insurance companies doing business there. The study reported that insurers realized very nice profits, above the national average. At the same time, consumers saw the average price for auto insurance drop from $747.97 in 1989, the year Proposition 103 was implemented, to $717.98 in 1998. Meanwhile, the average premium rose nationally from $551.95 in 1989 to $704.32 in 1998.

California's rank dropped from the third costliest state to the 20th and it has continued to maintain this position. According to the NAIC, the average annual premium in California in 2003 was $821.11 (20th in the nation) versus $820.91 for the nation. From the time California went from reliance solely on limited competition, as insurers envisioned, to full competition and regulation, the average auto rate insurance rose by 9.8 percent. Over the same time span, the national average rose by 48.7 percent. In 1989, California consumers were paying 36 percent more that the national average. By 2003, they paid premiums that were virtually the national average.

[1] "Why Not the Best? The Most Effective Auto Insurance Regulation in the Nation," June 6, 2000; (www.consumerfed.org.) Copy attached.