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S. Hrg. 103-660

S. 1989, INSURANCE POLICY TRANSFER ACT AND INSURANCE REDLINING

Y 4. C 73/7: S. HRG. 103-660

S. 1989, Insurance Policy Transfer...

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

MAY 26, 1994

Printed for the use of the Committee on Commerce, Science, and Transportation

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U.S. GOVERNMENT PRINTING OFFICE

79-871 CC WASHINGTON : 1994

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-044749-6

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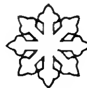

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S. 1989, INSURANCE POLICY TRANSFER ACT AND INSURANCE REDLINING

THURSDAY, MAY 26, 1994

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The committee met, pursuant to notice, at 2:35 p.m. in room SR–253, Russell Senate Office Building, Hon. Richard H. Bryan, presiding.

Staff members assigned to this hearing: Moses Boyd, senior counsel, and Claudia A. Simons, staff counsel; and Sherman Joyce, minority staff counsel.

OPENING STATEMENT OF SENATOR BRYAN

Senator BRYAN. Let me take this opportunity to welcome everyone to our hearing this afternoon. And I would especially like to extend a warm welcome to my colleague from the Judiciary Committee, Senator Howard Metzenbaum, who joins us here today and who has been instrumental in highlighting a problem that affects potentially thousands of consumers, namely the transferring of an insurance policy without the knowledge or the consent of the policyholder.

As consumers, when we purchase an insurance policy from one company, dutifully paying the premiums over the years, we do not expect to discover later that another company has taken over that policy. Yet as we will hear this afternoon, this is precisely what has happened to a number of policyholders throughout the country.

Insurance companies frequently transfer policies for a variety of legitimate business reasons. It is not my purpose here today in convening this hearing to suggest that we should prohibit all such transfers. However, I do have concern that these transfers, particularly when the assuming company is not as financially sound as the transferring insurer, are often effected without the knowledge or the consent of the policyholder.

One can only imagine a policyholder's surprise to learn that the strong, financially sound insurance company with which he had originally contracted has transferred his policy to a much weaker, financially distressed company. In many cases the policyholder learns of this transfer only when a claim is made and it is discovered that the new insurer cannot pay the claim.

It is particularly ironic that our efforts to prevent consumer fraud, which focuses on the informed consumer, advising that consumers must always check the credentials of any company before writing out a check, can be so easily frustrated in this context. S.

1989 is a step in the right direction to address this problem, and I look forward to hearing the testimony of our witnesses today as we seek a constructive solution to this problem. Mr. Chairman, your comments, please.

OPENING STATEMENT OF SENATOR HOLLINGS

The CHAIRMAN. This afternoon, the committee is holding a hearing to examine S. 1989, the Insurance Policy Transfer Act, legislation introduced by Senator Metzenbaum and cosponsored by Consumer Subcommittee Chairman Bryan.

The bill is intended to address a consumer problem that may be quite widespread. This problem arises when a consumer purchases an insurance policy from one insurance company and, without the consumer's knowledge or consent, that company subsequently transfers the policy to another company, which may be less financially sound than the original insurer.

There are certainly many legitimate reasons for one insurer to transfer individual or blocks of policies to another insurer. There have been instances, however, in which a policyholder did not become aware of the transfer until a claim was filed, only to find that the new insurer was financially distressed and unable to pay the claim. Some argue that the original insurer should at least be required to notify the policyholder, as a party to the insurance contract, of the transfer. Others contend that a policy transfer should not be allowed without the policyholder's actual consent.

The legislation before the committee attempts to address these types of problems by requiring insurers to notify and obtain consent from policyholders prior to a transfer. I look forward to the testimony of this panel of witnesses this afternoon.

Thank you, Mr. Chairman.

Senator BRYAN. Thank you, Mr. Chairman. Now, as I indicated at the outset, it is my privilege to welcome the Senior Senator from Ohio, Senator Howard Metzenbaum.

STATEMENT OF HON. HOWARD METZENBAUM, U.S. SENATOR FROM OHIO

Senator METZENBAUM. Senator Bryan, it is a pleasure to be here with you and work with you in connection with this subject. It is very seldom that I see fit to correct——

Senator BRYAN. The junior Senator, excuse me.

Senator METZENBAUM. Junior Senator, only senior by reason of my age.

I want to thank you for this hearing, which I hope will lead to greater protection for insurance consumers. Today's hearing concerns one of the most deplorable violations of business ethics that I have encountered in many years of business and public life. It is about the transfer of insurance policies from one insurance company to another without informing or obtaining the consent of the policyholders. It is an incredible situation.

There was a time when policyholders were assured that the insurer from whom they bought their policies was, in fact, bound to pay their claim, so long as they paid premiums. That meant that policyholders who carefully chose an insurer based on reputation and ratings did not have to read the fine print of every piece of

mail from their insurance company out of fear that their policy was transferred to a financially shaky insurer.

Senator Bryan, your attention to this subject is very, very important and necessary, and I cannot tell you how much I appreciate your leadership in this area. Because policyholders in the past could rest assured that their insurance company stood behind its contract for the next 10, 20, or 30 years, the insurance contract was based on trust between the insurer and the insured. Unfortunately, that was long ago and far away.

Today we witness the brave new world of insurance policy transfers, a world where insurance companies treat policyholders like baseball trading cards, swapping them with other companies when it suits their interests, and policyholders become mere commodities. Today an insurer who has bet wrong by selling a policy that turns out to be more costly or merely less profitable than expected just can dump the policies, walk away from its responsibilities. It can transfer the policies downhill to a more poorly rated insurer.

This practice has been given the incorrect name of assumption reinsurance. It should really be called policyholder dumping. It is outrageous because it often deceives and rips off policyholders. My subcommittee, the Antitrust Committee, investigated such transfers and held hearings. We found transfers from top-rated to unrated insurers were not that unusual, transfers in which policyholders were not asked if they wanted to be transferred. They were not told about the financial condition of the assuming insurer which failed.

Make no mistake about it, transfers to less financially healthy companies cause hardship and trauma and they should be an embarrassment to the entire insurance industry. Every president of every insurance company in this country ought to be sitting here in this audience or participating, urging that we do something about this embarrassing situation for the insurance industry.

When we conducted hearings we found one retired couple that could not get their $50,000 retirement annuity to complete a planned retirement home. They had to live in an unfinished workshop in the rear. In another case an elderly widow had to wait 4 years—4 years—after her husband died to get his life insurance policy proceeds. We will hear from a witness today who became unemployed and could not get access to his money.

What kind of an industry is this? And I must say to you that the failure of the NAIC and the entire insurance industry to deal with this problem is an embarrassment to the entire economic situation in this country, and the fact is the American people do not know about it or they would be up in arms.

The special feature of policy transfers is that the original insurer washes its hands of all obligations to the policyholders. Such transfers have two chief characteristics: The original company extinguishes all contractual liability to the insured and a new company assumes the original company's liability.

The following analogy describes how outrageous these policy transfers really are. Imagine you deposit $100,000 in a 5-year CD at Bank of the Rock. Bank of the Rock then transfers the money to Flim-Flam National without asking for your consent. You want your money back to buy a home; Bank of the Rock says, "Sorry, we

owe you nothing, we transferred the money to Flim-Flam, and Flim-Flam is insolvent and cannot pay." That is what having your insurance policy transferred is all about.

Another analogy. You pay Responsible Engineering to build a house for you. Responsible has been building solid homes for decades. Without your knowledge, Responsible transfers the contract to Fly By-Night Constructors, another company which has a reputation for shoddy work. Fly By-Night does not return calls, you want Responsible with whom you originally did business to build your home, but it says "Sorry, we transferred your contract to Fly By-Night and we owe you nothing."

You and I know this cannot happen in the banking and construction industries, but it does in insurance and the insurance industry permits it to go on and the NAIC permits it to go on, and it is an embarrassment to the entire economy. It is an embarrassment to an industry that claims it is the great industry of America, it is the backbone of the country.

It is not our responsibility only in the Senate to do something about it, it is the responsibility of the insurance industry. No other business, no human being could violate every law and principle like this, only the powerful insurance industry does and gets away with it.

If I sound a bit angry, I get angry about this because I think it is an incredible reality of our economy that the most powerful industry in all of America sits on their butts and does nothing when they ought to be meeting their share of responsibility, and the NAIC twiddles its thumbs and moves around and does not meet its responsibility either.

Very often, too often in fact, the second company in an insurance transfer is inferior to the first; that is pretty much the rule. Very often policyholders are not told about the transfer until it is a done deal. Very often policyholders are not told about the shaky financial condition of the assuming company. Informed consent is not a requirement of transfers.

Make no mistake, these are not just isolated cases. Transfers are common. In fact, according to testimony before my subcommittee, transfers have become increasingly more common. The A.M. Best Co. provided me with transfers listed in the 1994 Best Insurance Reports. No fewer—no fewer than 140 insurance companies listed in the report have engaged in transfers. Probably not all of them were bad, but a hell of a lot of them were bad, and they are an embarrassment to the entire economy and to the capitalist system of our country.

The Best list is silent testimony to the trauma and suffering endured by hundreds of thousands of consumers whose policies have been transferred to less financially secure companies without their consent. Many of those policyholders had major medical, disability, life, and retirement annuity policies.

How would you like it if you had paid premiums for 10, 15, or 20 years to the original insurance company only to have it transferred without your permission? That happened to an elderly couple in Minneapolis who paid premiums for 12 years. How many of us would really like it if we were totally disabled, confined to a bed,

a wheelchair, or a nursing home, and our policy was transferred to an insolvent or nearly insolvent insurer.

Because of this outrageous dumping of policyholders, I, along with Senator Bryan, introduced the Insurance Policy Transfer Act. The act will prevent the transfer of policyholders to less financially healthy companies. At the same time, it will promote transfers that are in the industry's and policyholders' best interests.

The Insurance Policy Transfer Act puts a requirement of good faith and fair dealing back in the insurance contract. It provides policyholders with a bill of rights. At the core is a requirement that transfers not take place unless policyholders give their informed consent. This means not merely the requirement to sign on the dotted line, but the right to the information necessary to make an informed decision.

Since there is no right without a remedy, the act provides policyholders the opportunity to go to Federal court to enforce their right not to be transferred without informed consent. The act does not leave it solely to some State insurance commissioner to enforce the policyholders' rights. Historically, State insurance commissioners are indistinguishable from the insurance industry, going through a revolving door either coming from the insurance industry and becoming the commissioner or going from the position of commissioner or superintendent and going into the industry. They are the classic example of regulatory capture, where the regulated industry captures the regulator.

Let me make a parenthetical comment, and that is you cannot make that statement that I just made and make it across the board. There are some who have been great as insurance regulators and who have maintained their sense of independence and integrity. But the reality is that they are so few and far between—and I think one of them is testifying today. They are so few and far between that they stand out like a beacon light out of a whole host of others that do not stand out very well.

Let me tell you where the State regulators are on this. They came up with a model law that never responded to some of the most harmful aspects of policy transfers. After I informed them of the inadequacy of their draft, the NAIC continued to propose a model law that does not protect policyholders. Let me say further that even if the NAIC could come up with the best model possible, which is not very likely based on its track record with other model laws, it would take 20 to 30 years before it would be adopted by a majority of States.

Policyholders do not have that law. Texas Commissioner Hunter, in his testimony today, agrees. The present situation of State-by-State insurance protection is an absurd catch-22. We have received written testimony from a witness who could not make it to the hearing. That testimony involves the transfer of policies from a top-rated Illinois insurance company to an insolvent Texas insurer. The Texas insurance company was not licensed in Illinois.

Illinois policyholders complained to the Texas and Illinois Departments of Insurance; they were put into a revolving door. The Texas department told my staff that it threw out most of the complaints because the Illinois Insurance Department was responsible, but the Illinois department said the Texas Department was respon-

sible and consequently threw out most of the complaints. Texas says Illinois is responsible, Illinois says Texas is responsible, and the poor guy who bought the insurance policy, and guys and gals are left holding the bag. It is absurd.

State commissioners either pass the buck or have their heads in the sand. Policyholders deserve better. Most insurance companies operate on a national basis. They should be governed by national law which provides policyholders with a floor of protection no matter where they live. If the States want to adopt their own laws in addition, fine.

One would think that practices as reprehensible as policy transfers, which are so contrary to basic contract law, would be impossible. Unfortunately, the insurance lobby is so powerful that it can defy and deflect progressive State laws. Federal legislation is needed to fill the gap. Its time has come. I hope the committee will adopt the Insurance Policy Transfer Act and protect policyholders against the overwhelming financial and legal power of the insurance industry.

Mr. Chairman, I ask that the documents and hearing records referred to in my statement be placed in the record.

Senator BRYAN. Without objection, that will be the order.

[The information referred to may be found in the committee files.]

Senator METZENBAUM. And, Mr. Chairman, again I want to say how much I appreciate your taking an interest in this subject, your being a cosponsor of this legislation, and I look forward to working with you. I have it on my agenda before I leave the U.S. Senate, to pass this bill.

Senator BRYAN. Senator, thank you very much. I appreciate your leadership as well, and the depth of your passion and conviction on this issue is evidence from your opening statement.

I think it might be appropriate now to have our first panel come to the table. We will begin having George Eliades, and I hope I am pronouncing his name correctly. Mr. Eliades was referred to obliquely in Senator Metzenbaum's opening statement. We will have Ms. Mary Griffin, who is the insurance counsel to the Consumers Union; Steven T. Foster, representing the National Association of Insurance Commissioners, and who serves presently as the Virginia Insurance Commissioner; Robert Hunter, the Commissioner of Insurance, the Department of Insurance, the State of Texas; and Dan Mica, the Executive Vice President of the American Council of Life Insurance, and joining him will be Richard Minck.

And as soon as you all get seated, we will begin by hearing Mr. Eliades' testimony.

STATEMENT OF GEORGE ELIADES

Mr. ELIADES. Mr. Chairman and members of the subcommittee, good afternoon. My name is George K. Eliades, and I reside in the greater Washington area in Fairfax County, VA. I wish to commend to you legislation to protect insurance policyholders from the abusive practice of transfers of policies between insurance companies sponsored by Senators Howard Metzenbaum and Richard Bryan. I would like to reinforce my support for this legislation, S. 1989, the Insurance Policy Transfer Act, by sharing with you my

experience resulting from the transfer of personal policies from a strong insurance company to a weak one in poor financial shape without my knowledge or informed consent.

I am very happy that you are interested in my policy transfer hardship experience, a victimization that could happen to any citizen. Thank you for inviting me to appear this afternoon. It is my hope that these important deliberations and your subsequent action may somehow also prove helpful in bringing the alleged criminals who created my hardship to justice. At any rate, this legislation can help prevent similar unnecessary and outrageous hardship from happening to you or any American citizen.

I support the need for safeguards that apparently do not now exist. S. 1989 is, I believe, a positive step to corrective action in preventing policy transfers not in the best interests of the policyholder.

On or about July 8, 1981, my financial planner, Carlton Coffey, contacted me about investing in annuity policies for retirement purposes. He informed me that the company with whom I would be investing, the American Health and Life Insurance Co. of Baltimore, MD, was a stable, growing company and that its annuities were a safe investment. He also told me that American Health and Life was rated A-plus by the A.M. Best insurance rating service.

I decided in favor of such an investment, and between July 1981 and April 1983, I opened three separate accounts with American Health and Life. Two of them were IRA accounts and one was a nonqualified deferred compensation plan. The aggregate value of the three accounts was over $30,000.

Sometime in July 1987 I received a letter from Guarantee Security Life Insurance Co. of Jacksonville, FL, notifying me that it had purchased the annuity business previously belonging to American Health and Life. I was not given the option as to whether I wanted my annuity to be invested with Guarantee Security Life, but was simply notified that this was a done deal. I did not inquire further, simply because I assumed that the annuity business must have been similar to home mortgages in that they could be sold without prior consent.

I have since learned that under current Florida law insurers need the consent of policyholders before transferring policies. I do not know when the current law became effective, nor if the law was simply ignored in 1987 when I was notified of the transfer of my policies to Guarantee Security Co. I do know that I was never asked for my consent nor provided with any information about the financial strength of Guarantee Security Life, if the law was, in fact, in effect at the time of the transfer in 1987.

In February 1991, I faced the plight of many Americans when I found myself unemployed. I had served 16 years as president of a small national trade association in the Washington, DC area, when I accepted the position of president of a larger trade association headquartered in the metropolitan Atlanta, GA, area. Shortly after the change in the annual elected volunteer leadership I was let go for arbitrary political reasons—which happens—and given 3 months severance pay.

After several months, I contacted Guarantee Security Life and requested a withdrawal of my money to tide me over during the pe-

riod of my unemployment and job search. The response I received was that the State of Florida had seized the company and placed it in rehabilitation. As a result, the assets of Guarantee Security Life had been frozen, and my only recourse for withdrawing my money was to file for a hardship exemption. This was the first I had heard of any trouble with Guarantee Security Life.

I proceeded to file for hardship exemption, but it was denied. The receivership had ruled against me on the grounds that I held personal assets; namely, my house. I was astounded that the State of Florida would require that I sell my house before they would agree to release my own money to me. Had I sold my house, there is no doubt in my mind but that the State of Florida would have then denied me my money for a second time on the grounds that I now had some cash from equity received from the sale of my house. The State of Florida in effect required that I must be both broke and homeless before serious consideration to returning my money to me.

For a period of 14 months my sole source of income was the $198 per week before taxes received from the Virginia Unemployment Commission. I was able to obtain temporary part-time jobs on an hourly basis from time to time, and my wife who had stayed home to raise our children was forced to find employment, as well. Ironically, the investment I thought would protect me in my time of need instead created an extraordinary hardship for me and my family.

I am happy to say that my wretched period of unemployment did come to an end, and I am again providing for my family. But I have not forgotten how desperate I was to withdraw my own hard-earned money from Guarantee Security Life, only to be treated by the State of Florida as though I was applying for a loan.

Mr. Chairman, I also find it equally appalling that I could invest my money in an A-plus rated company only to have that investment shunted off a few years later to a relatively new unrated company without my consent, without any information about the transfer or the purchasing company and no notification until I learned that the State of Florida had put the new firm into rehabilitation at the time I tried to withdraw my money.

I sincerely hope that my experience with Guarantee Security LIfe will help this subcommittee in its attempt to correct problems in the insurance industry, not the least of which is integrity. While I generally believe that minimum Federal regulation works best in a private enterprise system, in my personal opinion, if there is an industry in the United States that needs strict, consistent Federal controls, which would benefit the consuming public at large, it is the insurance industry. The American public should not have to put up with hardship because of transfers without consent and no financial strength or rating information on the acquiring company, the slow payment of legitimate claims and court awards, and other insurance practices not necessarily related to this specific legislation.

I believe S. 1989 will go a long way toward providing needed safeguards to all Americans against policy transfers that treat policyholders like commodities, traded like baseball cards. Claims by insurance executives that transfers could benefit consumers be-

cause the acquiring company may give better service is probably wishful thinking or an aberration, in my considered opinion, for the very reasons that some transfers may be pursued.

Again, I want to thank the subcommittee for its efforts and for giving me the opportunity to speak to you this afternoon. The lesson from my experience is very simple: There, but for the grace of God, goes I. What happened to me happens every day and it can happen to you—very easily.

If I had been able to stay with American Health and Life, the A-plus rated company I voluntarily and originally invested in, I would have been able to get my money without hardship in my time of need. But, because someone else decided and in fact moved my money to a poor risk company without my knowledge or informed consent, I did indeed experience unnecessary pain and economic hardship.

Thank you for your courtesy and consideration of my statement.

Senator BRYAN. Mr. Eliades, thank you very much. You plead, as the lawyers say, a compelling case.

Ms. Griffin, we would be pleased to hear from you next. Welcome.

STATEMENT OF MARY GRIFFIN, INSURANCE COUNSEL, CONSUMERS UNION

Ms. GRIFFIN. Thank you. Thank you very much for inviting us to testify today. We are delighted and applaud you, Mr. Chairman and Senator Metzenbaum, for introducing S. 1989, which provides needed and essential protection for consumers against transfers of insurance contracts without their knowledge or informed consent.

We believe that a consumer has a right to consent before substitution of parties to a contract takes place. It is a basic principle of contract law. Unfortunately, in the area of insurance this basic principle has not always been upheld in practice. Policyholders are not only transferred without their consent, as we just heard from Mr. Eliades, but in some cases with no knowledge of such a transfer until after the fact such as when a notice of a rate increase arrives in the mail.

Are consumers harmed by not being provided the opportunity for informed consent? Yes, in several ways. When policies are transferred to a poorly rated company, which many have done, a consumer does not have as strong a company backing the policy, and the company may go insolvent, again, as we just heard from Mr. Eliades.

While States have guaranty funds to protect policyholders in the event of insolvency, the funds are limited, take time to kick in, and may not be available if the company is not licensed in the State. Another problem consumers face is huge rate increases after the transfer. These premium increases may leave consumers with no choice but to lapse the policy in the hopes of finding better rates, which is improbable if you have preexisting conditions or are of advanced age.

What can consumers do? Consumers can complain about their policies being transferred, but often find that it is too late or the law of their State fails to protect them. Insurance departments are often unable to assist consumers because the laws do not provide

the needed tools. Most States do not inform consumers of their right to reject a transfer, and very few States provide any real protections to policyholders in the form of affirmative consent and specific notice requirements.

Consumers could call upon the courts to uphold their common law rights of contract. But not only is this an expensive and rarely viable option for most consumers, but consumers cannot predict what constitutes consent because of varying interpretations of the law and what fact patterns constitute consent. In the wake of Executive Life and other large national insurance solvencies, consumers have been asked to be more diligent when choosing an insurer. It seems unfair, however, for consumers to exercise due diligence in choosing an insurer only to find that transfers can take place without their consent.

That is why this legislation is so necessary. By requiring express written consent, relevant disclosures, and a private cause of action with attorneys fees, the bill provides a level of protection not currently found in most State laws and not necessarily afforded by the common law. The bill sets out a standard that is clear, simple, and predictable: written consent, or no transfer.

While consent is critical, such consent must be informed and meaningful. The disclosures provided in the bill contain information that is essential for a consumer making a decision about whether to agree to a transfer. We support these disclosures; in particular, financial data and information on the effect of a transfer on the financial condition are critical for consumers to be able to assess whether the new company will face financial ruin and whether there is solid financial backing of these policies.

An opinion by a disinterested third party expert, a requirement currently in Canadian law, provides the sort of guidance that consumers need when trying to sort through insurance information which can often be complicated and a statement from the chief insurance regulator. State regulators should be looking out for consumers. And while this is useful to the policyholder, certain standards should be established for how regulators determine whether the transfer notices are fair and a method for compliance with such standards. And by providing a private cause of action and attorney's fees, S. 1989 enhances the ability of consumers to obtain remedies for violations of the law.

In conclusion, I would like to quote from a policyholder whose health policy which she originally purchased with a high deductible to lower the premium was transferred and her premium increased by more than 35 percent. "We do not feel it is fair because of our ages. You just cannot drop a policy and start over, and you sure cannot afford the high premium with the high deductible together. I would like to know why the Government will not do anything about insurance companies."

Well, Senators, we appreciate that now the Government is doing something about this, and again, thank you for introducing this bill and thank you for allowing us to testify.

[The prepared statement of Ms. Griffin follows:]

PREPARED STATEMENT OF MARY GRIFFIN

Consumers Union[1] appreciates the opportunity to testify today on a bill that is designed to ensure consumers' insurance contract rights are protected. Consumers Union, publisher of Consumer Reports, has written extensively on insurance and for years has advocated for changes in the law that will bring fundamental rules of fair play and consumer protection to the insurance industry. We applaud you, Mr. Chairman, and Senator Metzenbaum, for introducing this piece of legislation which provides needed and essential consumer protection—prohibiting transfers of insurance contracts without the prior, informed written consent of the policyholder.

We believe that S. 1989 will protect consumers' insurance contract rights by requiring informed written consent of policyholders prior to the transfer and novation of insurance contracts. Our testimony today discusses the need for the legislation and the protections it will provide. We will submit a more detailed response to specific requirements under the bill, including some specific recommendations for improvement, at a later time.

THE NEED FOR LEGISLATION

We believe that a consumer is entitled to consent to a substitution of parties in a contract of insurance. Under general contract law, the original obligor can only be released from liability if a novation occurs. A novation results when a third party promises to assume a duty to the obligee, which in this case is the policyholder, and the obligee agrees to the substitution.[2] For a novation to take place, the obligee must assent to the discharge of the original party's, or insurer's, duty.[3] Release of the original obligor from all liability is essential, and mere acceptance of the obligation without agreement or intention to release is not sufficient to form a novation.[4]

Unfortunately, in the area of insurance, these principles of contract law have not always been upheld in practice. Policyholders are not only transferred without their consent, but in some cases with no knowledge of such a transfer until after the fact, such as when a notice of a rate increase arrives in the mail. Though consumers have the right to reject transfers, it is difficult for policyholders to consent to or reject a transfer in the absence of notice about the transfer or their right to reject the transfer. For example, policyholders receive notices after the fact informing them that "an agreement has been reached between [new company] and [former company] whereby your policy with [former company] has been reinsured and assumed by [new company]."[5]

Are consumers harmed by not being provided the opportunity for informed consent? Yes, for several reasons. While a transfer to a better rated or more fmancially sound company may provide more security for the policy, many transfers are from financially strong companies to weaker, lower-rated companies. Worse yet, some of the transfers that have taken place involved companies that were poorly rated and became insolvent soon after the transfer.

While states have guaranty funds to protect policyholders in the event of an insolvency, the policyholder may be out of luck if the company was not licensed in his or her state. Even if the policyholder is covered, states limit the amount of protection provided under the guaranty fund. And, it may be months or years before a policyholder can get money from the guaranty fund as some insolvencies take years to resolve.

When policies are transferred, the new companies often obtain steep rate increases on this transferred business. These increases may or may not be justified depending on the experience or the risks associated with that business and how the company can incorporate these policies into its existing business. These premium in-

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[1] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports with approximately 5 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

[2] Restatement (Second) of Contracts at 302.

[3] Id. at 280 cmt. d.

[4] *Security Benefit Life Ins. Co.* v. *Federal Deposit Insurance Corp.*, Civ. Act. No. 91-4023-5, October 6,1992, U.S. Dist. LEXIS 15784, p. 9 (citing Restatement (Second) of Contracts at 280).

[5] This language was contained in notices to policyholders from National Financial Insurance Company after it was transferred business from Reserve Life Insurance Company.

creases may leave consumers with no choice but to lapse the policy in the hope of finding better rates. But for many this is not an option, particularly with health insurance policies, because of age or preexisting conditions. As this distressed consumer wrote in a complaint after her and her husband's health policy, which she originally purchased with a high deductible to lower the premium, was transferred and her premium increased by more than 35 percent:

> We don't feel it's fair because of our ages, you just can't drop a policy and start over and you sure can't afford the high premium with the high deductible (sic) together. * * * I like to know why the government will not do anything about ins. co's.

In addition, policyholders may not get the same kind of service they came to rely on with their former company. The new insurer may not have convenient offices or other problems of accessibility may arise. In some situations, consumers have complained about the new company falling to pay their claims after months of calls and letters to the new company.

Consumers complain about their policies being transferred but often find it is too late or the law of their state fails to protect them. Insurance departments are often unable to assist consumers because the laws do not provide the needed tools. Or, if the insurance company is not licensed in the state, the policyholder's state may refer the complaint to another state, which may or may not take action depending on its priorities and resources.

State laws vary widely in the protection they afford consumers. Most states do not inform consumers of their right to reject a transfer. Only a few states require insurers to notify policyholders of the transfer as a condition of or prior to its completion. Still fewer states provide real protections to policyholders in the form of affirmative consent and specific notice requirements.

If the state regulatory agency cannot help, consumers can call upon the courts to apply common law principles of contract law to their policy. While courts have upheld the rights of insurance contract holders, this may not be a practical recourse for many consumers. Not only is this an expensive and rarely viable option for most consumers, but varying interpretations of the law and what fact patterns constitute consent may leave consumers unprotected.

In the wake of Executive Life and other large, national insurer insolvencies, consumers have been asked to be more diligent when choosing an insurer. More and more consumers are asking about the company's financial status, its servicing history, and its ability to pay claims—all relevant information that consumers should be seeking before entering into a contract with an insurer. It seems unfair, however, for consumers to exercise due diligence in choosing an insurer only to find that transfers can take place without their consent.

As the distressed consumer suggested, we believe that it is time for the government to do something about insurance company transfers. Only when policyholders are provided with information and the opportunity to reject or accept a transfer can they be assured that their contract rights are protected. The "Insurance Policy Transfer Act" goes a long way to providing the level of protection and security consumers deserve before entering into a contract.

PROTECTIONS PROVIDED BY THE "INSURANCE POLICY TRANSFER ACT"

The Requirement of Express Written Consent Protects Insurance Consumers' Contract Rights: The need for consent prior to a substitution in a contract situation is clear. S. 1989 provides a level of protection not currently found in most state laws and not necessarily afforded by the common law because the law, facts and circumstances are subject to varying interpretations. By requiring that written consent of the policyholder be obtained prior to the transfer, the bill sets out a standard that is clear, simple and predictable—written consent or no transfer.

Under common law, depending on the facts and circumstances presented in a particular case, the finder of fact may or may not find the evidence established the intent to consent. Therefore, any acts short of written consent should not be presumed to be per se evidence of consent because such a presumption takes away from the right to a case-by-case determination under common law.

As the court stated in *Security Benefit Life:* "If the intention of the parties to a transaction claimed to effect a novation is expressed in writing, the intention of the parties is a question of law for the court to decide. * * * Otherwise, the existence of such an agreement and the intention of the parties generally depends on oral testimony, and the existence of a novation is normally a question for the jury."[6] By providing that only prior written consent is sufficient for a transfer, without delin-

[6] *Security Benefit Life,* supra note 4 at p. 13.

eating those instances in which consent will be implied, the bill enhances rather than takes away from protections provided by the common law.

In section 5(b), the bill provides for transfers absent the express written consent of the policyholder if certain conditions are met. While this section provides policyholders with protection from downslope transfers (a transfer from a higher to a lower-rated company), we believe the term "implied consent" as used in this section is a misnomer. We suggest that this section be termed "exception" because to identify it as implied consent establishes an intent on the part of the policyholder that may not exist.

The standard of prior written consent clarifies what is needed to effect a novation, will help alleviate confusion for policyholders and companies alike, and provides guidance and protection for consumers nationwide. Under common law, the consumer cannot always predict what specific actions will lead to the requisite consent. Express written consent maintains the rights of policyholders by ensuring that only when written consent is given will their policies be transferred. Insurers can obtain clear consent of policyholders and rest assured that they can continue to enter into transfer agreements and avoid lengthy litigation over the issue of whether consent was implied.

The Notice Provisions allow for Informed and Meaningful Consent: While consent prior to a novation is a fundamental precept, such consent must be informed and meaningful. A consumer without the appropriate information and direction may not be any better off than a consumer with no choice. S. 1989 contains useful and important information for a consumer making a decision about whether to agree to a transfer. We suggest that minimum time periods for the notices be included in the statute or the appropriate agency be directed to develop such time periods.

In addition to providing information such as the name, address and telephone numbers of the assuming and transferring companies and the policyholder's right to consent, the notice provisions contain the following important disclosures:

- *Financial data:* While ratings may not always be completely accurate indicators of a company's financial condition, they are important tools for the consumer to assess the status of the companies.
- *Reason for transfer:* It is always helpful in determining whether to remain with a company to know why it wants to sell your policy to another company.
- *Effect of transfer on financial condition:* This information, coupled with the ratings, is essential for a consumer to determine whether the new company will have more capital backing up the policies and therefore a safer choice. It also may help assess whether to expect a large rate increase.
- *Opinion by a disinterested third party expert:* Since the financial data on insurance companies can be complicated and hard to sort through, an analysis from a third party expert is critical to the policyholder's ability to assess the transfer.
- *Statement from chief insurance regulator:* While this is useful to the policyholder, certain standards should be established for how regulators determine whether the transfer and notice are fair and a method for compliance with such standards.

A Private Cause of Action Assures Consumers' Ability to Seek Redress: By providing a private cause of action, S. 1989 enhances the ability of consumers to obtain remedies for violations of the law. Regulators who lack the time or the resources will be aided by allowing policyholders to bring actions against alleged wrongdoers.

We thank you for the opportunity to testify today.

Senator BRYAN. Thank you very much, Ms. Griffin. We appreciate your testimony. I am sure there will be some questions of you and Mr. Eliades and others.

Mr. Foster, welcome to our subcommittee hearing this afternoon.

STATEMENT OF STEVEN T. FOSTER, INSURANCE COMMISSIONER, STATE OF VIRGINIA; AND PAST PRESIDENT, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Mr. FOSTER. Mr. Chairman, Senator Metzenbaum, my name is Steven Foster. I am the Insurance Commissioner from the State of Virginia. I am the immediate past president of the National Association of Insurance Commissioners, and for 2 years, 1992 and 1993, I chaired the NAIC's Reinsurance Task Force which had amongst its projects the development of the model act which was adopted by the NAIC in December of this past year.

I might also add that prior to my career as an insurance commissioner my sole employment has been as a public servant for 10 years at the local level. Prior to that, I was in college.

I thank you for this opportunity this morning to be here to address this very important issue which is reflected in your bill, and I would like to add some comments at this time.

Assumption reinsurance has been our agenda at the NAIC for the last couple of years, and we have tried to find ways to afford better protections to consumers as to assumption reinsurance. We believe assumption reinsurance can serve a legitimate purpose for both insurers and for consumers. For example, if an insurer is in financial difficulty its solvency may in fact be improved by the transfer of a block of business to a healthier insurer. Assumption reinsurance transfer is also useful when insurers decide to discontinue a particular line of insurance.

In both cases, insurers and consumers could in fact be better off by a transfer. Yet at the same time, we are painfully aware that consumers have had problems with assumption reinsurance, and they have a right not only to know what has happened to their insurance contract, but to know enough to protect their vital interests. Also, consumers ought to be protected from ending up worse off as a result of a transfer, as in the case where the assuming insurer is or becomes impaired financially or where guaranty fund protection is eliminated by virtue of the transfer.

During the NAIC's deliberations on our model act we took extensive testimony from consumers, industry groups, and others, much as you are doing here today. We also have listened closely to the concerns expressed by Members of Congress. The act we adopted last December requires the prior approval of the insurance commissioner before any assumption reinsurance transaction can take place. This approval can be granted only if the assuming insurer is licensed in the commissioner's State, and is subject to all of the requirements of this model act with respect to residents of the State such as, for example, guaranty fund coverage.

In addition, the NAIC model also mandates important consumer disclosure protections. The transferring insurer must provide the policyholder with a notice of transfer. That notice must provide the consumer with, among other things, very detailed information as to the financial condition of the transferring and the assuming carrier, and notice that the policyholder has the right to either consent to or reject the transfer. Of utmost importance, the model leaves in the hands of the policyholder the ultimate power and say as to whether their policy is in fact transferred to another insurer.

As is the case with your bill, our model allows implied consent based on the consumer's inaction only after clear notification and a long period of time; in our case, in excess of 2 years. Express consent—that is, direct consumer action—was one of our goals in crafting this NAIC model. Most States already have a requirement that the commissioner's approval is needed prior to a transfer. Since December, five States have adopted laws or regulations based on the model act, which is less than 5 months old. Bills are pending in two other States which are based upon the model act.

Four States, including Virginia, have adopted laws to ensure that consumers have the right to reject a transfer. Virginia took such

action in 1993 at the same time that I was chairing the NAIC Model Act Committee on Assumption Reinsurance. We did not wait. We did not twiddle our thumbs. I went to our legislature and said put in the Virginia law that no Virginia resident shall have their contract transferred without their consent. That has been our law for over a year. Clearly, the States are already doing their job.

Let me now turn to the Insurance Policy Transfer Act, which is your bill. In this bill we obviously see much that we recognize from our own model act. Like the NAIC model, your bill includes a requirement for approval by the commissioner, extensive disclosure of financial information to the policyholder, the assurance that the policyholder may reject the transfer, and provisions for the expressed and implied consent of the policyholder.

Yet the differences highlight why the very idea of a Federal bill on this subject presents concerns to us. First and foremost, the Federal bill would grant to the Department of Commerce the authority to promulgate regulations to implement the law, whereas the NAIC model would leave such authority to State legislators and their regulators. Mr. Chairman, we are concerned that if you combine the Federal Government's previous poor record of financial service regulation with its lack of expertise and experience in insurance regulation you could be writing a recipe for disaster for the American consumer.

The policymaking reins in this area, we believe, should be left in the hands of State legislatures and their respective State insurance regulators. We have seen what the States have done already in several areas to put into their laws some of the protections which are in our model act, and certainly we would encourage, and I plan in Virginia to introduce a bill this next session which would offer these protections. Protection of consumers, we believe, is a very important business to us as State insurance regulators, as it has been for more than a century.

I thank you for this opportunity to testify and look forward to answering questions you may have.

[The prepared statement of Mr. Foster follows:]

PREPARED STATEMENT OF STEVEN T. FOSTER

Mr. Chairman, members of the Committee, my name is Steven Foster. I am the Past President of the National Association of Insurance Commissioners (NAIC) and the Commissioner of Insurance for the Commonwealth of Virginia, a position I have held for 7 years. I also served last year as the Chairman of the NAIC's Reinsurance Task Force, which has jurisdiction over all reinsurance issues, including the subject of today's hearing, assumption reinsurance. Our task force developed the NAIC's Assumption Reinsurance Model Act, which I will discuss today.

The NAIC is the oldest association of state public officials, whose members are the chief insurance regulatory officials of the 50 states, the District of Columbia, and four U.S. possessions. On behalf of the NAIC, I thank you for the opportunity to appear before this Committee to discuss the important issue of improving consumer protections for policyholders whose insurance policies are transferred from one company to another in what is known as an assumption reinsurance transaction. We are also grateful for the thoughtful oversight by this committee over the last several years regarding a wide range of important issues for insurance consumers.

Today, I will discuss the role played by assumption reinsurance transactions in the insurance marketplace, the potential benefits of such transfers as well as the hazards such transactions may pose to consumers, actions by the NAIC and the states to improve protections afforded to consumers against these hazards, and S. 1989, the Insurance Policy Transfer Act.

CONSUMER PROTECTION AND ASSUMPTION REINSURANCE

An assumption reinsurance agreement is a transaction in which an insurance company transfers the obligations and/or risks on insurance contracts to another insurer. This makes the assuming insurer directly liable to the policyholders and relieves the transferring insurer of that responsibility.

Assumption reinsurance agreements can be beneficial. If an insurer is in financial difficulty, that insurer's solvency may be improved in part by the transfer of a block of business to a healthier insurer. This is in the clear interest of policyholders of the troubled company. Not only does such a transfer increase the likelihood that the promises made by the insurer to the policyholder will be kept, but it also increases the likelihood that the service needs of the consumer will be met.

Assumption reinsurance transfers are also useful where an insurer, for any of a variety of reasons, has decided that it is not advisable to continue in a particular line of insurance. In this situation, it may better serve the policyholder for the insurer to transfer the existing business to an insurer that has a more vital, ongoing interest in conducting business in that particular line of insurance.

While we believe that assumption reinsurance transfers can be beneficial, we realize that consumers have important rights in such transfers. For example, consumers have a basic right not only to know what is happening to their insurance contract, but to know enough about what is happening to protect their interests. Second, we believe that consumers ought to be protected from ending up worse off as a result of a transfer, as in the case where the assuming insurer is or becomes impaired financially, or where guaranty and protection is lessened or eliminated by virtue of the transfer.

THE ACTIONS OF THE NAIC AND THE STATES ON ASSUMPTION REINSURANCE

The NAIC is sensitive to these consumer issues. State insurance regulators have debated the development of an effective means of guaranteeing consumer rights and of providing consumers with protections. We have taken extensive testimony from consumer representatives, industry groups, and other interested parties, and we have listened closely to the concerns expressed by members of Congress and others.

Last December, the NAIC adopted the Assumption Reinsurance Model Act, which I have included as an attachment to this statement (Attachment A). Briefly, the Model Act takes a two-pronged approach to protecting the interests of a policyholder whose contract is the subject of a proposed assumption reinsurance agreement. First, the Model requires the prior approval of the state insurance commissioner for any assumption reinsurance transaction. This approval could be granted only if the assuming insurer is licensed in the commissioner's state and is subject to all other requirements of the act with respect to residents of the state, such as guaranty fund coverage. In deciding whether to approve the transfer, the Commissioner would consider the financial condition of both companies, the competence, experience, and integrity of the management of the assuming insurer, the assuming insurer's plan for administration of the block of business, the fairness of the transfer, and the adequacy of the notice to policyholders.

The second prong of the Model Act's consumer protection hinges on disclosure to the consumer of the proposed assumption reinsurance agreement. Under the Model, the transferring insurer is required to provide to each policyholder and each policyholder's agent or broker a notice of transfer. That notice would provide the consumer with, among other things, very detailed information as to the financial condition of the assuming insurer and the fact that the policyholder has the right to either consent to or reject the transfer.

The financial information about both the transferring insurer and the assuming insurer that the transferring insurer would be required to provide policyholders is extensive. It would include:

- ratings for the last five years from two nationally recognized insurance rating services;
- end-of-the-year balance sheets for the previous three years and for the most recent quarter;
- a copy of the Management's Discussion and Analysis that was filed as a supplement to the previous year's annual statement, and
- an explanation of the reason for the transfer.

Under the NAIC's Model Act, policyholders have the right to reject the transfer of their insurance policies. They can do so simply by returning to the insurer a preaddressed, postage-paid response card, or by sending any other written notice indicating that the transfer is rejected.

The Model provides that the consent of a policyholder can be implied only in a couple of circumstances. First, if the policyholder pays a premium to the assuming

company during the 24-month period after receipt of the notice of transfer, and if the policyholder does not take advantage of the opportunity to make the premium payment under protest while withholding consent to the transfer, consent may be implied. It is important to note, however, that the premium notice from the company must clearly state that payment to the assuming insurer shall constitute acceptance of the transfer. The premium notice from the company must also provide a method for the policyholder to pay the premium while reserving the right to reject the transfer.

Implied consent may also be inferred from the consumer's inaction, but only after an extensive notification requirement and a long period of time. After no fewer than twenty-four months after the first notice, the transferring insurer must send a second notice to the policyholder. If, after an additional month, the policyholder still has not expressly consented or rejected the transfer, consent will be deemed to have been given.

It is clear from this statutory structure involving review of the proposed transfer and approval by the commissioner, extensive disclosure of financial and other information to the consumer, and ample opportunity for the consumer to reject the transfer, that express consent, as opposed to implied consent, is the NAIC's preferred mechanism for exercising a consumer's approval of a policy transfer. We believe that this approach goes the extra mile—with two notices over a 25-month period—to encourage a decision by the policyholder.

We are most encouraged by the response of the states to this brand new Model Law. All but a very few states already require the commissioner's approval for an assumption reinsurance transfer. Furthermore, as the chart I have provided with this statement illustrates (Attachment B); five states already have adopted laws or regulations based on the Model Law and these states have provided consumers with the opportunity to reject the transfer. Proposals based on the Model also are pending in two other states. Four states, including my own, already have provisions providing consumers with the right to reject assumption reinsurance transfers. Inasmuch as many state legislatures are still in session in this, the first legislative session after the NAIC adopted the Model Act, we consider this to be an encouraging affirmative response by the states.

S. 1989

As we examine S. 1989, the Insurance Policy Transfer Act sponsored by Senators Bryan and Metzenbaum, we see much that we recognize from our own Model Act. Like the NAIC Model Act, the bill includes the requirement of approval by the commissioner, extensive disclosure of financial information to the policyholder, the assurance that the policyholder may reject the transfer, and provisions for the expressed and implied consent of the policyholder.

These similarities serve to emphasize the fact that the NAIC Model Act contains what we agree are the essential components of consumer protection—oversight, disclosure, and the right to reject the transfer. Similarly, the primary differences highlight why the very idea of a federal bill on this subject gives us concern. First and foremost of these differences is the fact that the Insurance Policy Transfer Act would grant to the Department of Commerce the authority to promulgate regulations to implement the Act, whereas the NAIC Model Act would leave such authority with the state regulators. In the past, we have said the federal government has, at best, a poor record of financial services regulation. We have grave concern about the prospect that a federal bureaucracy with scant experience in insurance regulation would be charged with the implementation and enforcement of insurance regulations that have an impact on so many other aspects of insurance regulation. Our concern is compounded by the specter of a conflict between little or no enforcement by a federal agency and a state law that may be superseded, tying the hands of state regulators trying to protect consumers.

The other key point of disagreement between S. 1989 and the NAIC Model Act, the requirement of an independent "expert" opinion, also highlights our concern about federal intrusion into insurance regulation. The Senate bill does not take into account the difficulty inherent in finding actuaries without conflicts of interest, and the fact that actuaries are not regulated by any government entity. The overlooking of these facts, of which state insurance regulators are all too aware, underscores the fact that this sort of issue is best debated and decided by those who have the most experience with the issue—state insurance commissioners.

As you know, the business of insurance is regulated by the states, as it has been since New Hampshire established the first insurance department in 1851. Since the passage of the McCarran-Ferguson Act in 1945, that regulation by the states has been performed with the approval of and oversight by the U.S. Congress. State regu-

lators both acknowledge and welcome the oversight of this body. Indeed, on many occasions that oversight has helped state regulators to provide more effective protection to American insurance consumers.

While we welcome congressional oversight, we have long maintained that responsibility for regulation should remain with the states. This is not an issue of turf protection. Rather, it is an issue of preserving a system of good regulatory policymaking. Issues such as assumption reinsurance do not operate in a vacuum. Rather, they have implications that touch upon other aspects of insurance regulation. For example, assumption reinsurance is an issue that has broad implications for rehabilitations and liquidations of failed insurers, oversight of agents and brokers, the analysis of the financial condition of insurers, market conduct regulation, and the operation of guaranty funds. When one goes about improving consumer protection with regard to assumption reinsurance, one must also take into account the relationship of that issue to these other regulatory components. The soundest way to do that is to keep the reins of policymaking in the hands of the people who have responsibility over all these related regulatory issues and who deal with their interrelationship day in and day out. Those policymaking reins should be left with state insurance regulators, who have shown over the last century and a half that we are really quite good at protecting insurance consumers. In fact, we believe that the past decade has shown that the states do a better job at regulating insurance than the federal government does at regulating other financial institutions.

CONCLUSION

We certainly appreciate your level of concern over this important issue and the effort put forth in drafting a proposal to enhance protections for policyholders. Yet, as we have seen with the Employee Retirement Income Security Act (ERISA), the Liability Risk Retention Act (LRRA), and other instances where the federal government intrudes upon and preempts state insurance regulation, single-issue federal regulation can unleash a host of unintended consequences that can be disastrous for insurance consumers.

Again, let me stress that we welcome congressional oversight. We ask simply that you exercise that oversight with caution and an understanding that state regulators are both committed to improving consumer protection and quite expert at crafting integrated solutions to consumer protection problems.

ATTACHMENT A—ASSUMPTION REINSURANCE MODEL ACT

Section 1. Purpose

This Act provides for the regulation of the transfer and novation of contracts of insurance by way of assumption reinsurance. It defines assumption reinsurance and establishes notice and disclosure requirements which protect and define the rights and obligations of policyholders, regulators and the parties to assumption reinsurance agreements.

Section 2. Scope

A. This Act applies to any insurer authorized in this state which either assumes or transfers the obligations and/or risks on contracts of insurance pursuant to an assumption reinsurance agreement.

B. This Act does not apply to:

(1) Any reinsurance agreement or transaction in which the ceding insurer continues to remain directly liable for its insurance obligations and/or risks under the contracts of insurance subject to the reinsurance agreement;

(2) The substitution of one insurer for another upon the expiration of insurance coverage pursuant to statutory or contractual requirements and the issuance of a new contract of insurance by another insurer;

(3) The transfer of contracts of insurance pursuant to mergers or consolidations of two (2) or more insurers to the extent that those transactions are regulated by statute;

(4) Any insurer subject to a judicial order of liquidation or rehabilitation;

Drafting Note: This section is intended to apply to any similar proceedings under court order.

(5) Any reinsurance agreement or transaction to which a state insurance guaranty association is a party, provided that policyholders do not lose any rights or claims afforded under their original policies pursuant to [cite applicable state guaranty fund laws]; or

(6) The transfer of liabilities from one insurer to another under a single group policy upon the request of the group policyholder.

Section 3. Definitions

A. "Assuming insurer" means the insurer which acquires an insurance obligation and/or risk from the transferring insurer pursuant to an assumption reinsurance agreement.

B. "Assumption reinsurance agreement" means any contract which both:

(1) Transfers insurance obligations and/or risks of existing or in-force contracts of insurance from a transferring insurer to an assuming insurer; and

(2) Is intended to effect a novation of the transferred contract of insurance with the result that the assuming insurer becomes directly liable to the policyholders of the transferring insurer and the transferring insurer's insurance obligations and/or risks under the contracts are extinguished.

C. "Contract of insurance" means any written agreement between an insurer and policyholder pursuant to which the insurer, in exchange for premium or other consideration, agrees to assume an obligation and/or risk of the policyholder or to make payments on behalf of, or to, the policyholder or its beneficiaries; it shall include all property, casualty, life, health, accident, surety, title and annuity business authorized to be written pursuant to the insurance laws of this state.

Drafting Note: Individual states may cite specific sections of their insurance laws regarding lines, classes or types of insurance to which this Act is applicable. If a state has a statutory definition of contract of insurance which is inconsistent with this definition, the state may want to consider using the statutory definition.

D. "Home service business" means insurance business on which premiums are collected on a weekly or monthly basis by an agent of the insurer.

E. "Notice of transfer" means the written notice to policyholders required by Section 4A.

F. "Policyholder" means any individual or entity which has the right to terminate or otherwise alter the terms of a contract of insurance. It includes any certificateholder whose certificate is in force on the proposed effective date of the assumption, if the certificateholder has the right to keep the certificate in force without change in benefit following termination of the group policy.

The right to keep the certificate in force referred to in this section shall not include the right to elect individual coverage under the Consolidated omnibus Budget Reconciliation Act, ("COBRA") section 601, et seq., of the Employee Retirement Income security Act of 1974, as amended, 29 U.S.C. 1161 et seq.

G. "Transferring insurer" means the insurer which transfers an insurance obligation and/or risk to an assuming insurer pursuant to an assumption reinsurance agreement.

Section 4. Notice Requirements

A. Notice to Policyholders, Agents and Brokers:

(1) The transferring insurer shall provide or cause to be provided to each policyholder a notice of transfer by first-class mail, addressed to the policyholder's last known address or to the address to which premium notices or other policy documents are sent or, with respect to home service business, by personal delivery with acknowledged receipt. A notice of transfer shall also be sent to the transferring insurer's agents or brokers of record on the affected policies.

(2) The notice of transfer shall state or provide:

(a) The date the transfer and novation of the policyholder's contract of insurance is proposed to take place;

(b) The name, address and telephone number of the assuming and transferring insurer;

(c) That the policyholder has the right to either consent to or reject the transfer and novation;

(d) The procedures and time limit for consenting to or rejecting the transfer and novation;

(e) A summary of any effect that consenting to or rejecting the transfer and novation will have on the policyholder's rights;

(f) A statement that the assuming insurer is licensed to write the type of business being assumed in the state where the policyholder resides, or is otherwise authorized, as provided herein, to assume such business;

(g) The name and address of the person at the transferring insurer to whom the policyholder should send its written statement of acceptance or rejection of the transfer and novation; and

(h) The address and phone number of the insurance department where the policyholder resides so that the policyholder may write or call the insurance department for further information regarding the financial condition of the assuming insurer.

(i) The following financial data for both companies:

(i) Ratings for the last five (5) year. if available or for such lesser period as is available from two (2) nationally recognized insurance rating services acceptable to the commissioner including the rating service's explanation of the meaning of the ratings. If ratings are unavailable for any year of the five-year period, this shall also be disclosed;

Drafting Note: Insert the title of the chief insurance regulatory official wherever the term -commissioner" appears.

(ii) A balance sheet as of December 31 for the previous three (3) years if available or for such lesser period as is available and as of the date of the most recent quarterly statement;

(iii) A copy of the Management's Discussion and Analysis that was filed as a supplement to the previous year's annual statement; and

(iv) An explanation of the reason for the transfer.

(3) Notice in a form identical or substantially similar to Appendix A attached shall be deemed to comply with the requirements of Section 4A(2).

(4) The notice of transfer shall include a pre-addressed, postage-paid response card which a policyholder may return as its written statement of acceptance or rejection of the transfer and novation.

(5) The notice of transfer shall be filed as part of the prior approval requirement set forth in Section 4B(1).

B. Notification and Prior Approval Requirements

(1) Prior approval by the commissioner is required for any transaction where an insurer domiciled in this state assumes or transfers obligations and/or risks on contracts of insurance under an assumption reinsurance agreement. No insurer licensed in this state shall transfer obligations and/or risks on contracts of insurance issued to or owned by residents of this state to any insurer that is not licensed in this state. An insurer domiciled in this state shall not assume obligations and/or risks on contracts of insurance issued to or owned by policyholders residing in any other state unless it is licensed in the other state, or the insurance regulatory official of that state has approved the assumption.

(2) Any licensed foreign insurer that enters into an assumption reinsurance agreement which transfers the obligations and/or risks on contracts of insurance issued to or owned by residents of this state, shall file or cause to be filed with the commissioner of insurance of this state the assumption certificate, a copy of the notice of transfer and an affidavit that the transaction is subject to substantially similar requirements in the state of domicile of both the transferring and assuming insurer. If no such requirements exist in the domicile of either the transferring or assuming insurers, then the requirements of section 4B(3) shall apply.

Drafting Note: It is anticipated that the insurance department will review the filing in a manner consistent with the policy form review process applicable for the state which could include either prior approval or file and use.

(3) Any licensed foreign insurer that enters into an assumption reinsurance agreement which transfers the obligations and/or risks on contracts of insurance issued to or owned by residents of this state, shall obtain prior approval of the commissioner of insurance of this state and be subject to all other requirements of this Act with respect to residents of this state, unless the transferring and assuming insurers are subject to assumption reinsurance requirements adopted by statute or regulation in the jurisdiction of their domicile which are substantially similar to those contained herein.

(4) The following factors, along with such other factors as the commissioner deems appropriate under the circumstances, shall be considered by the commissioner in reviewing a request for approval:

(a) The financial condition of the transferring and assuming insurers and the effect the transaction will have on the financial condition of each company;

(b) The competence, experience and integrity of those persons who control the operation of the assuming insurer;

(c) The plans or proposals the assuming party has with respect to the administration of the policies subject to the proposed transfer;

(d) Whether the transfer is fair and reasonable to the policyholders of both companies; and

(e) Whether the notice of transfer to be provided by the insurer is fair, adequate and not misleading.

Section 5. Policyholder Rights

A. Policyholders shall have the right to reject the transfer and novation of their contracts of insurance. Policyholders electing to reject the assumption transaction

shall return to the transferring insurer the pre-addressed, postage-paid response card or other written notice and indicate thereon that the assumption is rejected (collectively referred to as the "Response Card").

B. Payment of any premium to the assuming company during the twenty-four-month period after notice is received shall be deemed to indicate the policyholder's acceptance of the transfer to the assuming insurer and a novation shall be deemed to have been effected, provided that the premium notice clearly states that payment of the premium to the assuming insurer shall constitute acceptance of the transfer. However, the premium notice shall also provide a method for the policyholder to pay the premium while reserving the right to reject the transfer. With respect to any home service business or any other business not using premium notices, the disclosures and procedural requirements of this subsection are to be set forth in the Notice of Transfer required by Section 4 and in the assumption certificate.

C. After no fewer than twenty-four (24) months from the mailing of the initial notice of transfer required under section 4A, if positive consent to, or rejection of, the transfer and assumption has not been received or consent has not been deemed to have occurred under Subsection B of this section, the transferring company shall send to the policyholder a second and final notice of transfer as specified in Section 4A. If the policyholder does not accept or reject the transfer during the one month period immediately following the date on which the transferring insurer mails the second and final notice of transfer, the policyholder's consent will be deemed to have occurred and novation of the contract will be effected. With respect to the home service business, or any other business not using premium notices, the twenty-four and one month periods shall be measured from the date of delivery of the Notice of Transfer pursuant to Section 4A(1).

D. The transferring insurer will be deemed to have received the Response Card on the date it is postmarked. A policyholder may also send its Response Card by facsimile or other electronic transmission or by registered mail, express delivery or courier service, in which case the Response Card shall be deemed to have been received by the assuming insurer on the date of actual receipt by the transferring insurer.

Section 6. Effect of Consent

If a policyholder consents to the transfer pursuant to Section 5 or if the transfer is effected under Section 7, there shall be a novation of the contract of insurance subject to the assumption reinsurance agreement with the result that the transferring insurer shall thereby be relieved of all insurance obligations and/or risks transferred under the assumption reinsurance agreement and the assuming insurer shall become directly and solely liable to the policyholder for those insurance obligations and/or risks.

Section 7. Commissioner's Discretion

If an insurer domiciled in this state or in a jurisdiction having a substantially similar law is deemed by the domiciliary commissioner to be in hazardous financial condition or an administrative proceeding has been instituted against it for the purpose of reorganizing or conserving the insurer, and the transfer of the contracts of insurance is in the best interest of the policyholders, as determined by the domiciliary commissioner, a transfer and novation may be effected notwithstanding the provisions of this Act. This may include a form of implied consent and adequate notification to the policyholder of the circumstances requiring the transfer as approved by the commissioner.

Drafting Note: States must amend their guaranty association law to specify that residents whose policies are transferred to an unlicensed insurer pursuant to this section are entitled to continued guaranty association protection.

Section 8. Effective Date

This Act shall take effect six (6) months after the date it is enacted and shall apply to all assumption reinsurance agreements entered into on or after that effective date.

NOTICE OF TRANSFER

IMPORTANT: THIS NOTICE AFFECTS YOUR CONTRACT RIGHTS. PLEASE READ IT CAREFULLY.

Transfer of Policy

The [ABC Insurance Company] has agreed to replace us as your insurer under [insert policy/certificate name and number] effective [insert date]. The [ABC Insur-

ance Company's] principal place of business is [insert address] and certain financial information concerning both companies is attached, including (1) ratings for the last five years, if available, or for such lesser period as is available from two nationally recognized insurance rating services; (2) balance sheets for the previous three years, if available, or for such lesser period as is available and as of the date of the most recent quarterly statement; (3) a copy of the Management's Discussion and Analysis that was filed as a supplement to the previous year's annual statement; and (4) an explanation of the reason for the transfer. You may obtain additional information concerning [ABC Insurance Company] from reference materials in your local library or by contacting your Insurance Commissioner at [insert address and phone number].

The [ABC Insurance Company] is licensed to write this coverage in your state. The Commissioner of Insurance in your state has reviewed the potential effect of the proposed transaction, and has approved the transaction.

Your Rights

You may choose to consent to or reject the transfer of your policy to [ABC Insurance Company]. If you want your policy transferred, you may notify us in writing by signing and returning the enclosed pre-addressed, postage-paid card or by writing to us at:

[Insert name, address and facsimile number of contact person.]

Payment of your premium to the assuming company will also constitute acceptance of the transaction. However, a method will be provided to allow you to pay the premium while reserving the right to reject the transfer.

If you reject the transfer, you may keep your policy with us or exercise any option under your policy. If we do not receive a written rejection you will, as a matter of law, have consented to the transfer. However, before this consent is final you will be provided a second notice of the transfer twenty-four months from now. After the second notice is provided, you will have one month to reply. If you have paid your premium to the (ABC Insurance Company], without reserving your right to reject the transfer, you will not receive a second notice.

Drafting Note: The second and final notice to the policyholders should include a date by which the policyholder should respond. The date should be one month after the date on which the notice was mailed to the policyholder.

Effect of Transfer

If you accept this transfer, [ABC Insurance Company] will be your insurer. It will have direct responsibility to you for the payment of all claims, benefits and for all other policy obligations. We will no longer have any obligations to you.

If you accept this transfer, you should make all premium payments and claims submissions to [ABC Insurance Company] and direct all questions to [ABC Insurance Company].

If you have any further questions about this agreement, you may contact [XYZ Insurance] or [ABC Insurance].

Sincerely,

[XYZ INSURANCE COMPANY
111 No Street, Smithville, USA, 555/ 555-5555]

[ABC INSURANCE COMPANY
222 No Street, Jonesville, USA, 333/ 333-3333]

For your convenience, we have enclosed a pre-addressed postage-paid response card. Please take time now to read the enclosed notice and complete and return the response card to us.

[Notice Date]

RESPONSE CARD

—— Yes, I accept the transfer of my policy from [name of transferring company] to [name of assuming company].

—— No, I reject the proposed transfer of my policy from [name of transferring company] to [name of assuming company] and wish to retain my policy with [name of transferring company].

Date; Signature; Name; Street Address; City, State, Zip.

Attachment B—NAIC State Provisions for Approval of Assumption Reinsurance

State	Citation	Provision
AL	§ 27–27–47 (stock); § 27–27–48 (mutual)	Bulk reinsurance agreements must be approved by commissioner before effective.
AK	§ 21.69.610 (stock); § 21,69.620 (mutual)	Bulk reinsurance agreements must be approved by commissioner before effective.
AZ	§ 20–730 (stock); § 20–734 (mutual)	Bulk reinsurance agreements must be approved by commissioner before effective.
AR	§ 23–62–205 (1991); Reg. 55 (1992)	Assumption reinsurance certificate approved by commissioner, delivered to policyholders; standards for commissioner approval.
CA	I.C. § 810	Assumption reinsurance agreement of group insurance or 10 or more individual contracts must have written consent of commissioner.
CO	Reg. 3–3–1	Assumption reinsurance agreements require approval by commissioner; notice to policyholders; amendments pending to adopt NAIC model.
CT	P.A. 91–41	Agreements to bulk reinsurance must be filed with commissioner; disapproval standards.
DE	Tit. 18 § 4944	Agreements of bulk reinsurance must be filed with commissioner before effective.
DC	§ 35–365	May reinsure all or risks with consent of superintendent.
FL	§ 628.481 (stock); § 628.491 (mutual)	Bulk reinsurance agreements subject to prior approval by commissioner.
GA	B 33–52–1 to 33–52–6	Provides for approval of assumption reinsurance agreements by commissioner, notice to policyholders, right of policyholders to reject transfer and novation; based on NAIC model.
HI	§ 431:4–501	Bulk reinsurance shall be considered a consolidation of the two companies.
ID	§ 41–2856 (stock); § 41–2858 (mutual)	Reinsurance of all or substantially all of insurance in force treated as merger (stock); prior approval required (mutual).
IL	215 ILCS 5/74	Prior approval of bulk reinsurance agreements by commissioner required.
IN	§ 27–6–1.1–5	Commissioner must approve proposed agreement of assumption reinsurance; if approved, must notify contract holders within 45 days.
IA	§ 521.3	Approval of any reinsurance contract by commissioner required.
KS	§ 40–221(a)	Prior approval by commissioner of any bulk reinsurance agreement required.
	§§ 40–1219 to 40–1219a	Requires notification of policyholders and written consent before transfer due to a merger or consolidation, except when insurer is impaired.
	Bulletin 1993–21 (1993)	Notifies insurers of procedure required by court decision.
KY	§ 304.24–420	Approval of bulk reinsurance agreements by commissioner required.
LA	R.S. 22:942	Written approval of bulk reinsurance agreements by commissioner required.
ME	Tit. 24–A §§ 761 to 766	Provides for approval of assumption reinsurance agreements by commissioner; notice to policyholders, right of policyholders to reject transfer and novation; based on NAIC model.
MD	48A § 273 (stock); 48A § 274 (mutual)	Prior approval of bulk reinsurance agreement by commissioner required.
MA	C. 175 § 20	Company ceding more than 75 percent of risk shall obtain prior approval of commissioner.
MI	§ 500.7604	Commissioner must give prior approval of reinsurance of all risks for purposes of effecting consolidation or merger.
MN	§ 60A.09	File assumption reinsurance agreements with commissioner.
MS	No provision	
MO	§ 375.241, Reg. 200–2.400	Requires approval of director; assumption reinsurance considered to be doing business in State.
	§ 436.125	Before transfer of obligation to pay annuity, must get written consent of obligee.

Attachment B—NAIC State Provisions for Approval of Assumption Reinsurance—Continued

State	Citation	Provision
	§§ 375.1280 to 375.1295	Notice to policyholders, opportunity to reject novation. If don't reject, after third notice deemed to have consented. Financial information on both insurers must be provided; based on NAIC model.
MT	§ 33–2–1211 (stock); § 33–2–1212 (mutual)	Prior approval of bulk reinsurance agreements by commissioner required.
NE	§ 44–224.03 (stock); § 44–224.05 (other than stock).	Prior approval of bulk reinsurance agreements by director required.
	§§ 44–6201 to 44–6211	Provides for approval of assumption reinsurance agreements by commissioner; notice to policyholders, right of policyholders to reject transfer and novation; based on NAIC model.
	Bulletin CB–85 (1993)	Format for notice of transfer.
NV	§ 693A.370	Prior approval of bulk reinsurance agreements by commissioner required.
NH	No provision	
NJ	§ 17B:18–64	Prior approval of bulk reinsurance agreements by commissioner required.
NM	§ 59A–34–40	Prior approval of bulk reinsurance agreements by superintendent required.
NY	§ 1308	Prior approval of bulk reinsurance agreements by superintendent required.
NC	Bull. 88–L–2	Proposed assumption reinsurance contracts must be filed with department 30 days prior to use.
ND	§§ 26.1–07–01 to 26.1–07–21	Approval of bulk reinsurance agreements by commissioner required.
OH	§ 3907.12 (legal reserve life); § 3925.33 (other than life).	Bulk reinsurance agreements need written consent of a three-person commission (legal reserve life); prior approval of bulk reinsurance agreements by commissioner (other than life).
OK	Tit. 36 § 2132 (stock); tit. 36 § 2134 (mutual)	Prior approval of bulk reinsurance agreements by commissioner required.
OR	No provision	
PA	Tit. 40 § 442	Approval of bulk reinsurance agreements by commissioner required.
	Reg. 90i.1 to 90i.3 (1993)	Department statement of policy required certificates of assumption be provided to policyholders. The purpose of the certificate is notification. Form must be approved by insurance department prior to issuance.
RI	§§ 27–53–1 to 27–53–7	Provides for prior approval by commissioner of all assumption reinsurance agreements, notice to policyholder, right of policyholder to reject transfer and novation; based on NAIC model.
SC	§ 38–27–310	Transfer of substantially all liabilities without prior approval is grounds for rehabilitation.
SD	§ 58–5–120 (domestic stock); § 58–5–123 (domestic mutual).	Prior approval of bulk reinsurance agreements by director required.
TN	Dept. policy	Letter of notification of assumption sent to commissioner. No requirement for approval. Department approves assumption certificates only. Form letter sent to assuming company and policyholders informing them of 60-day notice and right to refuse the assumption.
TX	28 TAC 7.604	Any domestic insurer reinsuring its entire outstanding business must file documents with the commissioner to allow determination that all policyholder interests are being protected.
UT	§ 31A–22–1204	Approval of commissioner required for bulk reinsurance agreements.
VT	T. 8 § 3435	Prior approval of bulk reinsurance agreements required; commissioner may require notification of policyholders, policyholder may reject the reinsurance.
	SB 341 pending (1994)	Based on NAIC model with 12-month/2-month period for rejection.

Attachment B—NAIC State Provisions for Approval of Assumption Reinsurance—Continued

State	Citation	Provision
VA	§ 38.2–136	Policyholders may consent to any assumption unless the commissioner enters an order of approval when the ceding insurer is in impaired financial condition and the transfer is in the best interests of the policyholders.
WA	Reg. 284–95–010 to 284–95–080	Provide 30 days' notice to policyholders and commissioner; policyholders may consent or reject; assumption of policies is considered doing business in State.
WV	§ 33–4–15	Insurer must seek advance approval of commissioner which may include consideration of whether it would substantially reduce the protection of policyholders.
WI	§ 611.78 (domestic); § 618.32 (foreign)	Report reinsurance transaction to commissioner 31 days in advance of proposed effective date.
WY	§ 26–24–150	Prior approval of bulk reinsurance agreements by commissioner required.

Every attempt has been made to provide correct and complete information. For further information, consult the statutes and regulations cited.

Senator BRYAN. Mr. Hunter.

STATEMENT OF ROBERT HUNTER, COMMISSIONER, TEXAS DEPARTMENT OF INSURANCE

Mr. HUNTER. Mr. Chairman, my name is Bob Hunter. I am Insurance Commissioner for the State of Texas. I really congratulate you for leading on this issue. I want to go out of my way to commend you on this. I would like to see some changes in the bill to strengthen it, but I think it is a terrific start.

The bill contains the essence of what is needed to protect consumers. The transfer shall not be effective as to an individual consumer unless that consumer has made an informed consent to the transfer. That is the essence of protection. I commend both of you for your leadership.

I fully support each of the 14 disclosures you require, particularly disclosures of adverse consequences of the transfer, ratings from all the ratings organizations for both the transferring and assuming insurer, and a fairness opinion of a disinterested third party which, as was pointed out, does occur in other countries, and the commissioner's certification from both States that the transaction is in the best interest of the policyholders.

I suggest strengthening the disclosures by requiring not only disclosure of consent to the transfer, but how to object to it, also requiring notice to the consumers of any third parties who refuse to provide a fairness opinion, and prior approval of any commissioner of insurance that has a substantial block, say over 20 percent of the policies to be transferred in his or her State, because you might have two States involved in the transfer, but a third State might have most of the business and not be involved in the approval, and I think it should be.

I would also suggest these consumer protections be added to the bill: one, the consumer should be provided with the right to coverage from either insurer if the transfer is found to be in violation of the act; two, that standards for the third party and Commissioner approvals of the transfer should be considered and put into the act; three, transferring insurers should be required to carry all liabilities on their books for policies that have not yet consented to transfer; four, very importantly, Congress should provide greater

flexibility to the Commissioner in the transferring company's domiciliary State to transfer policies of a financially weak insurer—I think maybe it is too stringent the way it is drafted; and five, the insurance commissioner must be empowered to enforce this act, not the Department of Commerce. I think we are in a better position to monitor compliance.

Although I am in some disagreement with Stephen Foster of the NAIC on this issue, I am a firm advocate of State regulation, Mr. Chairman. Senator Metzenbaum, it is true that historically there has been a revolving door—50 percent of the commissioners have come from the industry and returned to it, and that has been a serious problem, but you know me well for all these years that we have worked together on these issues, and I am going to tell you something is changing.

Senator METZENBAUM. If they were all like you, Mr. Hunter, we would not have problems.

Mr. HUNTER. But the States and NAIC are changing fast. You probably remember Jay Angloff, who was my general counsel and worked for Congress Watch. He is now the commissioner in Missouri. We have exconsumer leaders, bona fide consumer leaders in Oregon, Washington, and Georgia. Several other States have commissioners that are clearly consumer-oriented.

To show the change, at the last NAIC meeting, 18 States supported the call for an end to the passing of lobbying costs and political advertising costs through the consumers. I imagine a few years ago, Senator, if that had been proposed you would have gotten no support at all—18 States went public with that support.

So, Senator Metzenbaum, all I can say, you deserve much of the credit for the change, but your consistent call for improvement over these years is why I think these things are happening, and I just wanted to say how much I appreciate—on behalf of consumers all over America, I appreciate what you have done all of these years, so I would like to thank you very much.

[The prepared statement of Mr. Hunter follows:]

PREPARED STATEMENT OF J. ROBERT HUNTER

My name is J. Robert Hunter. I am the Insurance Commissioner from the State of Texas. I previously served as Federal Insurance Administrator under Presidents Ford and Carter and as President of the National Insurance Consumer Organization.

I am testifying today in support of S. 1989 as an overdue solution to the dangers of assumption reinsurance for consumers across the country. My comments are divided into three areas: (1) identification of the key protections contained in the bill, protections which must remain for the law to successfully protect consumers, (2) the problems with the NMC draft model act and the necessity for national legislation, and (3) some suggested amendments to the bill to further protect consumers.

KEY CONSUMER PROTECTIONS CONTAINED IN THE BILL

S. 1989 adopts the correct fundamental concept for the protection of consumers in the assumption reinsurance transaction: the transfer shall not be effective as to an individual consumer unless that consumer has made an informed consent to the transfer. Any legislation which permits the transfer of the insurer's responsibilities without the informed consent of the insured must be rejected. I commend Senators Metzenbaum and Bryan for drafting a bill that not only requires disclosure of the fact of the transfer, but guarantees that the consumer will be provided key information to make an informed decision on whether to agree or object to the transfer. I support the disclosure of each item set out in Section 4(c) of the bill and will discuss the key items and the need for the information.

Section 4(c)(5) requires a summary of the adverse effects of consenting to the transfer. Of course, this information is per se required for a consumer to make an informed choice. I have little doubt that insurers will point out the alleged benefits of the transfer; they should be required to point out both sides of the equation.

Section 4(c)(7) requires a statement that the assuming insurer is licensed in the state or otherwise authorized to assume the insurance business. This provision is crucial because state guaranty fund protections are typically provided only to licensed companies. Thus, if the policy is transferred to a financially weak company that is not licensed in the consumer's state, the consumer would otherwise be left unprotected in the event of an insolvency.

Section 4(c)(10) requires the disclosure of financial data for the transferring insurer and the assuming insurer, including ratings from all nationally recognized rating firms, financial statements and a disclosure of the purpose of the transfer. It is important to include disclosure of all ratings because the insurer should not be permitted to disclose only the highest ratings. Financial data about the companies is crucial because of the nature of assumption reinsurance. In some cases, the transferring insurer seeks the transfer because the book of business is no longer profitable or is too expensive to manage. Not surprisingly, in these cases the willing buyers often tend to be financially weak companies. Consumers need to know this.

Section 4(c)(12) requires a disinterested third party "fairness opinion" finding that the transaction is in the best interest of consumers affected by the transaction. While insurance departments would do their best to review proposed assumption reinsurance transactions, their workload may prevent them from reviewing all necessary information. It is important to have a disinterested third party review the transaction to ensure that consumers' interests are protected.

Section 4(c)(13) requires a certification by the commissioners of the states of domicile of the transferring and assuming insurers that the transaction is in the best interests of policyholders affected by the transaction. This provision is crucial because Insurance Departments keep information about an insurer's financial status confidential in many cases. The certification will allow the Commissioners to disapprove such a transaction without revealing the confidential information.

I believe that all fourteen of the required disclosures contained in Section 4(c) are critical, and I recommend that none of those disclosures be eliminated from the bill. Below I offer some amendments to those disclosure requirements to further strengthen the protections for consumers.

THE NEED FOR NATIONAL LEGISLATION

There are three major reasons for Congress to act on assumption reinsurance rather than waiting for an NMC model law to be adopted by the states. These reasons are: substance, uniformity and timing. I will address each of these issues. My comments should not be read as a criticism of the NMC but, rather, as an acknowledgment of the realities regarding NMC model laws. Unlike Congress, NMC Commissioners only meet on a quarterly basis. So the NMC process is, by its nature, slow. This is usually okay, but in this instance people are being hurt by transfers today and action should come soon. Further, once the NMC acts, each individual state legislature must then adopt the model act, adding more time to the process. In most circumstances, a longer and more deliberative process benefits consumers and the industry. For issues such as assumption reinsurance, however, where consumers are currently being harmed, we need to move faster to protect citizens. As a firm believer in state regulation, I believe federal standards where uniformity is needed will assure that state regulation continues to serve America well.

The current NMC draft model law on assumption reinsurance falls short of providing the necessary consumer protections that are contained in S. 1989. Here are a few examples:

- The very purpose of the NMC model is flawed. Its purpose is to provide "for the regulation of the transfer and novation of contracts of insurance by way of assumption reinsurance." This purpose has the mistaken assumption that the end of legislation is to provide for regulation. Regulation should never be an end, it should be a means to reaching an end, like the protection of consumers. S. 1989, on the other hand, hits the mark exactly: "It is the purpose of this Act to prohibit the transfer and novation of a contract of insurance without the prior informed written consent of the policyholder." That is the goal any legislation should have regarding assumption reinsurance. The fundamental failure of the NMC model is its failure to recognize that the purpose of the legislation is to ensure that consumers make an informed consent to any assumption reinsurance transaction. That fundamental failure to have a purpose other than the creation of regulation permeates the failure of the act to effectively protect the interests of policyholders.

• The model act only requires disclosure of two financial ratings. Of course, this allows the insurers to simply pick the highest two ratings by all rating services for the assuming insurer. Since each insurer has its own ratings by all rating services, the benefits of full disclosure outweigh the minimal cost in making two additional rating service disclosures.

• The model act provides that payment of premium to the assuming insurer constitutes consent to the transfer. This provision violates the fundamental concept on which any assumption reinsurance legislation should be based: no transfer of a policy shall be effective without the (1) informed (2) consent of the insured. Payment of the premium to the assuming insurer satisfies neither of these two requirements. Payment does not evidence consent to the transfer or that the insured has read any of the materials included in the disclosure.

Second, national legislation will provide needed uniformity to assumption reinsurance transactions. Most reinsurance transactions affect consumers in many, if not all, states. National legislation will ensure that all consumers will be adequately protected and that insurers will not be required to comply with different and possibly contradictory state requirements, and will eliminate the duplication of efforts by each state in regulating assumption reinsurance transactions.

Third, national legislation will ensure more timely protection of insurance consumers. The NMC's procedure for drafting model legislation takes a long time, usually several years. Further, many NMC model bills are enacted by only a few states so protection may never be complete. While waiting for implementation of an NMC model law will likely take several years before the public would be protected, Congress can act this year and provide those protections to consumers immediately.

SUGGESTIONS FOR STRENGTHENING THE BILL

While I strongly support the bill overall, I do have some minor suggestions for strengthening the protections for consumers. Those suggestions are as follows:

Disclosures

Section 4(c) contains the disclosures required before an insurer may transfer a policy. As stated above, these disclosures are crucial to ensuring that the consumer makes an informed decision. I have several suggestions for furthering the goals of consumer education and consumer protection, as follows:

• Section 4(c)(4) requires disclosure of the method for consenting to the transfer. The disclosure should also provide the method of objecting to the transfer.

• Section 4(c)(12) requires disclosure of the third party "fairness opinion" stating that the transfer is in the best interest of the policyholders. The insurer, in attempting to obtain such an opinion, may receive a third party opinion that the transfer is not in the policyholders' best interest. Presumably the insurer will simply obtain another opinion. Consumers should be informed of both opinions. Thus, I recommend that the section include an additional disclosure of any third parties that refused to provide a fairness opinion, along with the third party's name, address, phone number and reasons for refusing to provide the fairness opinion.

• Section 4(c)(7) requires a statement that the assuming insurer is licensed in the state or otherwise authorized to assume the insurance business. The purpose of this provision is to ensure that the consumer remains protected by the state's guaranty association. However, it is possible that a company is authorized to assume the business but is not covered by the guaranty association. No transfer should be permitted unless the assuming insurer is covered by the state's guaranty association. Thus, I recommend that the disclosure also require that the policy will continue to be covered by the state's guaranty association after the transfer.

• Section 4(c)(13) requires certain statements by the commissioner of the states in which the assuming and transferring insurers are domiciled. While I support the need for this disclosure, the approval of other commissioners should be required when consumers in another state make up a substantial portion of the block of business to be transferred. For instance, a threshold of 20 percent would require the same disclosure from the commissioner of any state in which consumers who hold at least 20 percent of the policies to be transferred reside.

Additional Consumer Protections

I have several recommendations for further consumer protections that could be added to the bill. Again, these suggestions are intended to further the bill's goal of protecting policyholders in the assumption reinsurance transaction. My recommendations are as follows:

• Although a transfer is deemed void unless it complies with the bill's requirements, the consumer should be provided with the right to coverage from either the assuming or the transferring company m the event a transfer is made in violation

of the Act. The right to coverage from the assuming insurer better protects the consumer's potential for being paid on a claim, especially when the transferring company has not carried the liability on its books and may no longer be in a position to pay all claims. Since the consumer has a contractual right against the transferring insurer, the consumer assumes the right of the transferring company to force the assuming company to pay the claim. This provision will also ensure that assuming companies will have an incentive to see that the transaction complies with the law.

- No standards are set out for third party and commissioners to determine when to approve a transaction as being in the best interest of the policyholders. Congress should consider adding standards for these determinations. For instance, the review should take into consideration any change in rates or benefits, the financial health of the assuming and transferring insurers, and the service level of the two insurers. The NMC draft model act sets out some standards, but that list needs to be expanded.
- Transferring insurers should be required to carry all liabilities on their books for policies on which they have not received a consent to the transfer. This will ensure that the company's books and records accurately reflect the company's financial status.
- A protection needs to be added for those consumers who allow their coverage to lapse in protest against the transfer of coverage. This reaction is known as "shock lapse," and the rate of lapse is particularly high when the assuming insurer has low financial ratings. The protections in the bill should significantly reduce the amount of lapses because consumers will be given a clear choice to remain with the transferring insurer. However, some lapses may still occur when companies fail to comply with the act. I recommend that a provision be added to provide that a transfer in violation of the act is considered a breach of the insurance contract and entitles any consumer who has had their policy lapse after the transfer to reinstate the policy by paying all back premiums. You may want to put a two year limit on a consumer's ability to exercise this right.
- Congress should consider providing greater freedom to the commissioner in the transferring company's domicile to transfer policies of a financially weak company.
- An additional issue which needs to be addressed is whether the bill should provide immunity for third parties who offer or refuse to offer a fairness opinion from liability to policy holders. On one hand, the purpose of the opinion is to have policyholders rely on it, so the third party should pay any damages caused by the breach of its duty. On the other hand, few firms will be willing to engage in this work if they face potential lawsuits in multiple states. While I do not have an opinion on this issue, I recommend that Congress address the issue prior to passage of the bill.
- Section 8 provides relief for policyholders for violations of the Act. It is crucial that this section empower the states, specifically the insurance commissioners, to enforce this Act. State insurance departments are in a better position to monitor compliance with the Act and issue such orders as necessary in a timely manner to protect consumers.

CONCLUSION

I support the adoption of S. 1989 and I encourage adoption of the minor changes I have recommended. The current practice of insurers, who sell policies based on their price, service and financial strength, in transferring their obligations to another insurer without the informed consent of the policyholder is unfair and deceptive. Senators Metzenbaum and Bryan should be commended for their fine work on this important consumer protection issue.

I would be happy to respond to any questions you may have.

Senator BRYAN. Thank you very much, Mr. Hunter. Mr. Mica, we will hear from you next.

STATEMENT OF DAN MICA, EXECUTIVE VICE PRESIDENT, AMERICAN COUNCIL OF LIFE INSURANCE; ACCOMPANIED BY RICHARD MINCK, EXECUTIVE VICE PRESIDENT

Mr. MICA. Thank you, Mr. Chairman. My name is Dan Mica. I am the executive vice president of the American Council of Life Insurance, and as you know, we are a national trade association representing over 600 legal reserve life insurance companies, and to-

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gether they write about 90 percent, over 90 percent of the life insurance in force.

Accompanying me is Dick Minck, another executive vice president of ACLI, and an actuary with many years of experience in the life insurance and annuity business. We are very pleased to be with you this morning, and on behalf of our member companies, do appreciate the opportunity to be here, and your invitation.

We both think policyholders in our member companies have benefited from the attention you and Senator Metzenbaum have given to the important subject of assumption reinsurance. The National Association of Insurance Commissioners, as you know, looked at assumption reinsurance. We heard that here today closely, and they have developed a model bill, model legislation which will be considered by States.

The attention has been useful, because it has encouraged us to consider the appropriate balance between the several interests involved. In general, the NAIC assumption reinsurance model act has reflected what we think is a balanced and meaningful and appropriate way.

It allows companies to use assumption reinsurance to leave a line of business in which they may not be able to compete effectively. It safeguards policyholders' current rights, and it preserves the regulators' abilities to move business from financially troubled insurers to a sound one.

We do think that balance is important, and we certainly have some areas where we may want to strengthen this model or have some differences with the model.

At this point, I would like to call on Dick Minck to provide some background on assumption reinsurance.

Senator BRYAN. Mr. Minck, I am sorry the table is not set up more conveniently. If you would pull that microphone as closely as possible, we do want to get the benefit of your testimony.

Mr. MINCK. Mr. Chairman, thank you. There are two general types of insurance. One is described in the vernacular of the trade as indemnity reinsurance, which has been in existence for—well, both have been in existence for many years.

The question might—and under indemnity reinsurance, an insurance company will cede coverage to a second insurer and will be paid by that second insurer based on the claims that eventually emerge. However, under indemnity reinsurance, the first carrier, the one from whom the policy was first purchased, will be responsible for paying the claims. The second carrier will reimburse the first carrier. In effect, the first carrier will have been acquiring insurance for itself from another source.

Now, why would you need something different than that, assumption reinsurance, and there are two areas that you generally find it. One is when a company is in trouble, where the company will not continue in existence, will not be there to pay claims, and either the insurance company itself or a regulator has found another company that will assume that business as a block.

In that circumstance, it is sensible for the policyholders involved to come to the new company for payment of claims, because that is the only company that will be there.

There is a second circumstance that has come about more frequently in recent years, because of the great competition that has been generated under the economy we have lived with since the oil crisis and high interest rates first appeared in the late seventies, and that is people changing their types of policies, the operations they are in, offering new kinds of contracts, and finding when they got down there they were not competitive, that there were other companies that did a lot better, and in those cases the companies decide that they had better get out of that business and let someone who can do it more effectively do it.

Now, you sometimes run into that in other lines of business such as property and casualty. I, for example, had an umbrella coverage with a company for 20-odd years and got a letter from them a month ago saying they were not going to renew it. They were no longer competitive in that line. They were going out of business, and they suggested I find another company, and so I found another company, and that is perfectly reasonable.

But with life insurance and annuity contracts that option is not open. They are long-term contracts. They are renewable. You cannot bring them to an end on an anniversary, so that the companies involved find someone who will do the business better and sell that block of business to them.

Now, those are the two principal reasons that you find most of these assumption reinsurance contracts going, two important reasons, and that is why they have it, and we are concerned that whatever we do to straighten out the problems that have been identified will not make it impossible to write assumption reinsurance in those cases where it is needed.

Let me turn it back to Mr. Mica.

Mr. MICA. As I close, Mr. Chairman, let me make a few comments, and as I said earlier, the intention on assumption reinsurance given by you and Senator Metzenbaum and NAIC has been very fruitful. It has revealed, as was indicated here today, some problems with some particular transactions, as well as some areas of serious mutual concern, some of what information the policyholder needs and can reasonably use when a block of policies is being sold.

Our companies care not only about the ability to pay future claims, but we have to and must care about the concerns and feelings of our customers. Our companies sell promises of future performance, and that means that they must have and we must act to have the public's confidence and respect, and I surely understand the comments that Senator Metzenbaum has made here today. Reasonable men do have differences of opinions on approaches, however.

The increased attention on the assumption reinsurance transactions has received has given us an opportunity to discuss those problems and concerns that have arisen and take some steps that enhance the public's confidence in our industry and in State regulation. We think that NAIC's model act attempts to strike an appropriate and reasonable balance of the interest of all parties concerned.

I might note here that I was informed this morning that some 44 States, 44 States now require the insurance commissioner's of-

fice to be notified before any transaction on assumption reinsurance can take place, so that, too, the States have also come to acknowledge the concern on these problems.

The bill, as I am discussing here, the model, it allows continued use of assumption reinsurance subject to many limitations and restrictions. It clarifies policyholders' rights without diminishing those current common law rights. One of those common law rights that I was informed of is that the most recent court decisions allow individual policyholders to hold both companies liable in the case of assumption reinsurance, the ceding company and the other company. It also gives additional regulatory oversight and control by requiring, as I just indicated, regulatory approval of the transactions.

As States enact the approaches contained in the model act, policyholders, regulators, and companies will benefit.

I see that my time is up. I will try to summarize a page or two here and essentially say that we do have some concerns about the utilization of the Department of Commerce, and certainly a Federal regulation. The need to create a new Federal bureaucracy and move it to a Federal level causes a great deal of concern, when, indeed, many feel that this can best be addressed as a part of an overall system at the State level.

Let me make a comment on the rating agencies, and even the disinterested third party. We do have some questions about the disinterested third party. Obviously, that party would either have to be unpaid, or paid by one or the other individuals involved in the situation, and we are not sure how that would work.

The other is the highest possible rating. There is a requirement that it move to the highest possible rating. These commercial rating services are available, but certainly a close review would indicate that the insurance industry, although one of the stronger industries in ratings and the financial services area, does not have a large number of companies rated AAA. Ultimately, it could result, we feel, in a very concentrated area where these policies would be shifted, and ultimately could be very difficult and cause greater problems for the consumers.

I have noted here in my testimony that only a few companies buy Standard & Poor's, Moody's, Duff & Phelps, and very few have rated A-plus or better. Most companies are currently rated only by A.M. Best or by qualified ratings of Standard & Poor's that go no higher than what we call the BBBQ rating.

In essence, as currently written, the legislation would bar all activities of assumption reinsurance for the vast majority of companies, and as was indicated in testimony earlier, there are a number of good reasons to move these policies quickly, particularly when you have a company that is facing problems.

I would just say in conclusion there are other points raised in my testimony. I would be happy to answer questions on them, but we do oppose the legislation on several grounds as it is currently written, or even if it were modified. One of the most basic, obviously, is the question that has been here for many, many years, is should it be State, should it be Federal, and if it is Federal, is that dual regulation, and would dual regulation work.

Thank you.

[The prepared statement of Mr. Mica follows:]

PREPARED STATEMENT OF DAN MICA

My name is Dan Mica. I am an Executive Vice President of the American Council of Life Insurance, or ACLI. The ACLI is a national trade association of 616 legal reserve life insurance companies who together write about 90 percent of the life insurance in force in the United States. Accompanying me is Dick Minck, who is also an Executive Vice President of ACLI, and an actuary with mane years of experience in the life insurance and annuity business. We are personally pleased to be asked to be with you this morning to share some of our perceptions, and the members of ACLI appreciate your invitation.

We think both policyholders and our member companies have benefited from the attention that has been given to the important subject of assumption reinsurance. The National Association of Insurance Commissioners has, as you know, looked at assumption reinsurance closely and has recently developed model legislation which will be considered by the states.

The attention has been useful because it has encouraged us to consider the appropriate balance among the several interests involved. In general, the NAIC's Assumption Reinsurance Model Act has reflected that balance in a meaningful and appropriate way. It allows companies to use assumption reinsurance to leave a line of business in which they may not be able to compete effectively; it safeguards policyholders' current rights; and it preserves the regulators' ability to move business from a financially troubled insurer to a sound one. We think that balance is important.

Now, let me ask Mr. Minck to provide a little background on assumption reinsurance.

THE NEED FOR ASSUMPTION REINSURANCE

Assumption reinsurance is the sale or transfer of a block of existing insurance policies from one company to another. It has little in common with most reinsurance contracts, sometimes described as "indemnity reinsurance." In indemnity reinsurance, the insurer that sold policies is still directly obligated to pay claims on those policies, but will recover some of the costs from another insurer—a sort of insurance for insurers.

Under indemnity reinsurance, the first insurer is directly liable to the policyholder or to the beneficiary, and the second insurer is directly liable only to the first insurer, not to the policyholder. The policyholder is not directly involved with the agreement. The first insurer is known usually as the ceding insurer, and the second insurer is usually known as the assuming insurer because it has assumed an obligation to reimburse the ceding insurer for its losses.

By contrast, in assumption reinsurance, the assuming insurer agrees to be directly liable to the policyholder. The ceding insurer ("seller") and the assuming insurer ("buyer") want the policyholder to accept the buyer in substitution of the seller. One basic question is: which company is liable to the policyholder? Under current law, in many situations both mad be, depending on the facts and circumstances. Moreover, Policyholders have substantial remedies to enforce those rights.

Many observers mad have been confused by the Practical and legal differences between indemnity reinsurance and assumption reinsurance. They mad also have underestimated a policyholder's current legal rights and remedies. Clarifying policyholder rights is an important and laudable goal, but its pursuit should not deprive companies and regulators of a useful tool like assumption reinsurance.

In the last two decades, certainly since interest rates skyrocketed in the late 1970's, the life insurance and annuity business has become considerably more turbulent than it was when I started out in the industry. Competition has always been fierce, but-margins have never been thinner. The industry is constantly designing new products, and existing products are supplanted. A related result has been that consolidations have increased, in some part to achieve needed economies of scale. That is one of the major reasons why assumption reinsurance is a necessary business tool for our industry.

Life insurance and annuities are, in particular, very long-term contracts that can continue in force for mane decades. Before death benefits or annuity benefits become payable, mane unforeseen events mad occur. As businesses, life insurers must adapt to economic circumstances unforeseen when policies were issued. That is why insurers need to be able to sell or transfer a block of existing policies. Assumption reinsurance can allow the industry and individual insurers to accommodate and to ad-

just to economic changes. Its use can promote economies of scale, reduce barriers to market entry and exit, and promote efficient allocation of resources.

An example of changing economic circumstances might be a small life insurer with a block of universal life insurance. Assume that the insurer designed and sold a product that was competitive. Suppose that its costs for maintaining investment management and systems staffs rose beyond what it had projected and were continuing to rise while demand for the product was slackening. What would an insurer's options be in such a situation?

The insurer could retain those policies and pay those expenses, of course, but the result would be a decreasing number of policyholders who would bear increasing costs. That would be bad for the policyholders. Another option might be for the insurer to try to maintain the level of charges to the policyholders by using up existing surplus. That might work, at least as lone as the surplus lasted, but it is obvious that such an option would eventually be bad for policyholders.

A third option for the insurer might be to sell or to transfer the block to another insurer that has already achieved economies of scale in administering its own universal life insurance line of business. If the transfer is done responsibly and well, it can benefit the affected policyholders. Their policies would bear lower expense charges, and possibly receive higher interest crediting rates,' as a result, more policies would continue in force.

Now, Mr. Mica would like to readdress recent developments.

S. 1989 AND STATES—OUR COMPANIES' CONCERNS

As I said earlier, the attention given to assumption reinsurance by Senator Metzenbaum and the NAIC has been fruitful. It has revealed problems in a few particular transactions, as well as some areas of serious mutual concern, such as what information the policyholder needs and can reasonably use when a block of policies is being sold.

Our companies care not only about their ability to pay future claims, but also for the feelings of their customers. Our companies sell promises of future performance, and that means they must have the public's confidence and respect. The increased attention assumption reinsurance transactions have received has given us the opportunity to address those problems and concerns that have arisen, and to take some steps that should enhance the public's confidence in our industry and in state regulation.

The NAIC's Model Act attempts to strike an appropriate and reasonable balance of the interests of all concerned parties. Although we have had concerns over some details of the Model, it allows the continued use of assumption reinsurance, subject to mane limitations and restrictions. It clarifies policyholder rights, without diminishing those current, common law rights. It also gives additional regulatory oversight and control by requiring regulatory approval of the transactions. As states enact the approaches contained in this Model, policyholders, regulators, and companies will benefit.

The overall regulation of the business of insurance lies with the states, and we believe that the current state regulatory system is best situated and equipped to handle assumption reinsurance transactions. S. 1989 incorporates many of the provisions of the NAIC Model, but it would single out the regulatory jurisdiction over assumption reinsurance transactions and transfer it to the U.S. Department of Commerce, with the Secretary of Commerce charged with promulgating regulations. Despite the preemption contained in the bill, the result would be dual regulation of the companies Involved. To be effective, the regulation of assumption reinsurance bust be carried out within a total regulatory system. Such regulation cannot be successfully carried out in a vacuum. For example, the NAIC Model Act provides for an important exemption where a state insurance guaranty association is a party. S. 1989 does not provide for such an exemption. This could hamper and complicate the current state system of providing continuing coverage to policyholders where an insurance company has become insolvent. S. 1989 also fails to exempt the transfer of liabilities under a group policy upon the request of the group policyholder. These differences could cause additional state versus federal conflicts.

In addition to creating the problems inherent in dual regulation, the passage of S. 1989 could actually hurt policyholders in the lone run. The bill prescribes necessarily untested statutory concepts which would preempt the current common law that has evolved to protect policyholders. Most of the decisions in cases where a transferring insurer did not obtain informed positive consent from policyholders, and where the assuming insurer became insolvent, have held the transferring insurer liable.

In addition, S. 1989 contains a number of provisions that would make it more difficult to use assumption reinsurance. One example is the requirement that implied consent cannot take place for three years, even if a policyholder has paid premiums to the new company each month for twelve months (or twenty-four months). A second example is the requirement of finding a "disinterested" third-party expert to determine that the transfer is fair and in the best interests of the policyholders; this would be difficult if the expert must be unpaid in order to qualify as "disinterested."

Another provision of S. 1989 that would make it difficult to use assumption reinsurance is the prohibition of any implied consent unless the transfer is to an insurer with the "highest possible rating" or with a rating higher than the selling insurer. The "highest possible rating" requirement would be too restrictive since there are verb few companies rated "AAA" by S&P, Moody's and Duff and Phelps, and verb few rated "A++" by A.M. Best. Most companies are currently rated only by A.M. Best or by the "qualified" ratings of S&P that go no higher than BBBq. Thus, S. 1989 would effectively bar the vast majority of U.S. life insurance companies from ever a effectively completing the transfer of blocks of business due to the near impossible requirement of receiving a written positive response from each policyholder.

In conclusion, we urge you not to mark-up this bill or and modified version of it that would preempt state law and lead to a dual system of insurance regulation, but rather to allow the states to address this matter on the basis of concepts contained in the NAIC Model.

Senator BRYAN. Thank you very much, Mr. Mica. As Senator Metzenbaum observed in his opening statement, he is the essential part of a quorum that needs to be convened at another important committee hearing, and I am going to yield to him first to ask some questions, and then I will follow up.

Senator Metzenbaum.

Senator METZENBAUM. Thank you very much, Mr. Chairman.

Mr. Mica, I have known you for some years, and you served in Congress with us, and when you speak, you speak very smoothly, but when you act, you do not act quite so smoothly, and I am going to be frank in my opinion.

The insurance industry, and that applies to the ACLI, has done a terrible job, an indifferent and an irresponsible job in its concern for its policyholders, particularly those policyholders who are transferred.

The ACLI opposed the NAIC's model law on policy transfers in the letter to the NAIC last June. That letter called policy transfers "a business tool." They are not tools. They represent the financial well-being of people like this gentleman over here, who woke up one day and found that what he thought was a solid position with an insurance company—and he asked for his $30,000 and he did not get it, and when that happens, it would seem to me that the ACLI would want to move in and try to be helpful, but you have not been.

Your position ignores the concerns of the policyholders, and frankly, I have some real questions as to how you arrive at that position for some of your companies. You are mutual companies, many of you, and really you are supposed to be speaking for your policyholders.

Instead, you forget you have got policyholders, and somehow some of the company executives are so arrogant they think they are responsible to absolutely no one. As Mr. Shin of Metropolitan Life said before my committee some years ago, he said, "We are not responsible to anyone. We are just responsible to ourselves."

In addition, your letter to the NAIC criticized the NAIC position because it gave too much, not too little disclosure to the policyholders.

You also did not like the NAIC proposal to have companies wait 3 years before transferring policyholders without their consent. You even thought policyholders should be transferred to States in which the new company was not licensed. How could you advocate positions such as these and still say you want to protect policyholders?

What in the industry provides policyholders that are being transferred with essential information to make informed decisions such as the financial statements of the company, the financial statements reflecting the transfer, the ratings of the companies, and the statements of what those ratings mean? Would not that be the right thing to do, Mr. Mica?

Mr. MICA. Well, Senator, first let me start out by the testimony you mentioned of an executive with a company some years ago. I personally disagree with that statement, and I will tell you that I think that I hope the leadership of our industry would all disagree with that. We do have a responsibility to the policyholders, and we should make that clear.

Second, each of the items mentioned in that letter were part of negotiations that were ongoing about the NAIC model act—for instance, the question about 3 years.

Senator METZENBAUM. But you did write such a letter, though, you or somebody else.

Mr. MICA. Actually, I was not aware of that letter, but I know there were negotiations going on. But I know, for instance, the example you mentioned, that 3-year waiting period, and I think there is a legitimate question there. I had just heard a little bit about this in the last few days.

The question was raised when a policyholder's policy is transferred, if that policyholder pays his premium or her premium for 1 year, is that enough for implied consent? 2 years, is that enough? 3 years, 5 years, 10 years?

How many years does the person have to pay for you to at least feel that they have accepted the transfer, and the debate was at the time, should it be 2 or 3 years? That was the locus of that particular question.

I do not recall each of the ones there, but again, those were positions that were being taken during negotiations on the legislation.

To date, there are still other areas that I think we have disagreement and other areas we have full agreement with the NAIC, but I think that it does show, if you will, that we do not always have an agreement, or they do not roll over for the industry.

Senator METZENBAUM. Let me just tell you what you wrote in the letter—well, Carolyn Cobb wrote the letter—but she said, "Our members feel that the common law currently more than adequately protects policyholder interest."

I know damn well that is not the fact. Common law does not protect the policyholder interest. Ask this man over here.

She goes on to say, "We think this model will effectively eliminate assumption reinsurance as a business tool." Now, she is the managing counsel of the American Council of Life Insurance; and she goes on to say, "The proposed 36-month window is an unworkable timeframe for implied consent."

And she was not just writing on her own; she wrote copies of it to a number of other people.

Mr. MICA. Well, I can comment on the common law aspect, and that is something I did ask about, also.

It appears—and it is my understanding under more current court decisions the last few years—the courts as they are ruling on assumption reinsurance, as I understand it, are now saying that you cannot do much of what happened in this situation with the first witness; that either company or both companies will be liable.

If you go to the company that has become insolvent, then you can go back to the original company.

Senator METZENBAUM. I am not aware of that being the fact. When Security Benefit Life—Security Benefit Life of Kansas—was transferred to Life Insurance of Pennsylvania, an unrated company now failed, they did not pay off until some of us in Congress jumped up and down; and finally they decided to pay off.

When American Life and Casualty, which had an A-plus rating, was transferred to Guarantee Security Life of Florida, unrated and failed, the policyholders were left high and dry.

I do not know if they ever subsequently collected when Capital Life of Colorado, A-plus rating, Mutual Security Life of Indiana, C-plus; when Reserve Life of Texas, A-plus, the National Financial Insurance, C-plus; a whole slew of other transfers.

Are you still going to sit there and tell me the industry is protecting the policyholders?

Mr. MICA. Let me just restate again, Senator, it is absolutely, without a doubt, in our interests to do everything we can to see the situations that occur like they did to the gentleman at this table, do not occur.

Senator METZENBAUM. Tell me one instance in which ACLI ever intervened in a matter of that kind. Maybe in Security Benefit Life?

Mr. MICA. Well, I can tell you one I just realized this morning. It did not dawn on me until I was looking over this that I, myself, held a policy from a major top-rated company, six policies. Incidentally, one of those policies was transferred just before that company went bankrupt. And I now have a policy with another company that is viable.

And so the ceding took place, in my case, just the opposite.

Senator METZENBAUM. The company that you bought the policy with went bankrupt, is that what you are saying?

Mr. MICA. The company I bought the policy with went insolvent. You know the name of it. And it turned out that they had ceded the policy to a company that I do not think—I have not checked—had a rating as high as the company that I purchased it with. But I have ultimately benefited from that business tool, if you will.

Mr. MINCK. Just as a footnote on that: The company that Mr. Mica refers to sold a large block of its business through one of these assumption reinsurance businesses—in fact, its group business. And as a result of that, there were much more in the way of funds available for the other policyholders. They would have had much less, if they had not been able to do it in a very timely fashion.

Mr. MICA. Senator, it is a problem, and needs to be addressed. We all agree on that. I think there are two basic questions that

come into play here; and I think this is going to go on, as long as the debate goes: Should it be State? Or should it be Federal?

And then, some questions on detail: Should it be 24 months? 36 months? Informed consent: Does that mean, if they signed the document, does that mean they read the document? In other cases where they are required under various insurance regulators to sign something, indicating that they have read something, we found that after they have signed it they still have not read it.

So, there is room.

Senator METZENBAUM. Mr. Mica, have you ever tried to read an insurance policy? I want to tell you, I was a coif graduate of law. I was a very good lawyer, headed up my own law firm. I look at those insurance policies, with all that fine print, and it moves over and it usually says, "So and so, and so and so accept, as provided in paragraph C–1(a)," and I go over to C–1(a) and then it provides some exception, "except as provided in paragraph F–2." By the time I get about one-third of the way through, I throw the policy aside.

Mr. MICA. You know, Senator, I asked that question when I first came with the industry some 4 or 5 years ago, and said the same thing, that, "I really do not read my policies; I cannot. And let us talk to some of our insurance lawyers, and see how we can do a better job."

And what I came to conclusion was, and what they indicated to me in many, many instances, they say to me and others who work with the legislature, "If you can change the laws in a way that they clearly delineate who has which right and which does not, we can change our policies."

But, because of so many legal decisions, court decisions, and so many laws that we have to deal with, we have to write policies——

Senator METZENBAUM. If you tell Senator Bryan what you need changed, then he will take care of that.

Mr. Hunter, give me your view as to whether or not the NAIC proposal moves far enough, or whether it provides enough protection; and in your opinion, what date all 50 States will have concluded passage of the legislation.

Mr. HUNTER. Well, first of all, it is impossible for me to predict when 50 States might pass legislation. My best guess would be, maybe never.

Senator METZENBAUM. Maybe never?

Mr. HUNTER. Yes, because there are a lot of model bills that some States do not enact; so it is hard to predict when 50 would enact. I think pieces of it could get enacted, but in terms of actually the model bill, I would say, probably never. And I listed in my testimony some problems I had with it.

I thought more than two financial ratings should be involved. I thought that there should be written consent from the consumer; and that the payment of premium to an assuming insurer constituting consent was, I thought, inappropriate.

Senator METZENBAUM. Mr. Eliades, you were out in the cold for a while; and apparently came back in. But did you ever get covered on the $30,000 you expected? Or did that just go by the boards?

Mr. ELIADES. I have not received a penny in receivership. Yes, I hope at some point in the future to receive some of my money

back. I expect to get something back, but, I do not know how much it will be nor when. At this point, I have not received anything.

And sir, may I comment on the idea of whether the insurance industry should be State-regulated or federally regulated.

Part of the problem is, there are 50 States and 50 sets of regulations. If they want to simplify the process, then let the Federal Government regulate the industry—with one, consistently applied set of rules, across the Nation. As I said in my testimony, I do not generally favor Federal regulation of the private enterprise system; but I do think that the arrogance of the insurance industry is outrageous and out of control—they do not know how to behave nor treat people. Federal regulation would simplify the process for them and clear up a lot of confusion and arrogant behavior. Federal regulation would make the rules consistent throughout the 50 States.

As to whether or not informed consent should be 3, 4, 5, or 6 years, it was 6 years before my policy was sold, without my informed consent. And 4 more years passed, before I found out the acquiring company was in bankruptcy and I was not going to get anything.

I do not think that there should be any 3, 4, or 5 years before the company can transfer funds without informed consent. I think, at any point in time, a policyholder should have the right to decide what happens to his money; whether it is transferred to another firm, or what.

I do not believe that the insurance company should have that right, to make a transfer decision without giving us information on the financial strength of the potential acquiring company. For as long as they have our money, we should be able to say "No, I don't want my money transferred to another company."

Senator METZENBAUM. Mr. Foster, you have heard Mr. Eliades. He is stuck, $30,000 plus interest that he has not been receiving. NAIC. Any thoughts about that? What can be done? What should have been done?

Mr. FOSTER. No, but I would be happy to speak as his insurance commissioner, if he now lives in Fairfax, VA. I want to get his card, and give him my card before I leave. Because there may be something we can do. It depends on the nature of these contracts, and the extent to which there is or is not guarantee fund coverage.

I took very careful notes, but I cannot conclude from my notes if there is or is not. But he is a resident of Virginia, and I would be happy to lend the assistance of my office to help him. Because there is no excuse for what happened to him. I cannot excuse for a moment any insurance company transferring a policy without any notice to the policyholder.

Senator METZENBAUM. This is obviously an intelligent man. He headed up a trade association; he speaks well in making his presentation. And he and, I would guess, many hundreds of thousands, perhaps—I do not know how many—were all left out in the cold.

And the insurance commissioners are not doing anything for him. He writes the insurance commissioner; and the insurance commissioner tells him to sell his home and go broke, before he can——

Mr. FOSTER. I cannot respond; but I will check into why that took place in Texas and Illinois. I do not know what the circumstances were there.

I know, when you are a receiver for an insurance company, you oftentimes have hardship provisions that allow for the release of funds to specified policyholders. We had it with Fidelity Bankers Life Insurance Co. We did not require that a person show us they had sold their primary residence, as an indication.

So, I would be happy to check into that, and see if I can give any assistance to him, dealing with those two States.

Senator METZENBAUM. I would hope, in your doing so, you would also find out why—was it Florida you were in?

Mr. ELIADES. Yes, sir.

Senator METZENBAUM. Why Florida—which really at this time has a strong insurance commissioner who just took on Met Life in a real out-and-out battle that I am sure you all know more about than I do; but, as I see it, did one hell of a job. And so, my guess is, he was not the commissioner at the time this occurred.

Mr. FOSTER. Well, he said 1987. My guess is, back in those days Florida, like Virginia, did not have the law we have on the books today. Our law now prohibits transfers without policyholder consent.

Senator METZENBAUM. Just let me ask: Can there be implied consent? Or is it written consent?

Mr. FOSTER. Our statute right now just says "consent." We put this on the books, frankly, because as you know, we took some time to get input from all parties on our NAIC model act. You provided input, as did others; and I thought, as the chair of the committee, it was important to take, if need be, 3 more months or 6 more months.

We did not wait, in Virginia. I said, "Let us put a law on our books right now," which was a year ago, prior to the NAIC model act being adopted. But I do think now, in fact I know, with the model act on the books we will go by it. But it will be express consent. That is what we believe the statute currently means, and that is how we will interpret it.

Senator METZENBAUM. Mr. Chairman, I think I have imposed upon your time enough. I think that—I appreciate greatly your support and your concern on this subject; and look forward, about the third day, we get back to passing our legislation.

Senator BRYAN. Thank you very much, Senator Metzenbaum. I think the questions were illuminating, and I am going to follow up on some of them. I know your staff is going to be able to remain after you leave, for another hearing.

But once again, I appreciate your interest and your support.

Senator METZENBAUM. Thank you very much.

Senator BRYAN. Thank you very much. Ms. Griffin, let me begin with a question for you. I have a baseline question that I am a bit confused on.

Under the common law, setting aside for a moment the insurance contract, an obligor cannot extinguish his, her, or its liability by transferring that obligation to another party. Another party may assume that obligation, and you may indeed have a third-party beneficiary arrangement as a consequence of that; but both the

original obligor and the assuming party are legally responsible generally, as an abstract proposition in the common law.

Is there something that is unique to insurance contract law? Or are there statutory provisions that create an exception to the rule? Can you give me a very encapsulated view of what the state of the law is, with respect to the transfer of insurance contracts under the circumstance that Mr. Eliades had?

Ms. GRIFFIN. Under the circumstance Mr. Eliades had, I believe he could get recourse through the common law. The common law—and this has been a little bit confused in the process—the common law requires consent. The question is: What rises to the level, for the court, what rises to the level to be considered consent?

If there is a written instrument, such as is in S. 1989, it would be a question of law. It would be fairly simple. It would be a matter of summary judgment.

Anything other than that, it is the question of the intent of the parties; and each case would turn upon the facts of the case. Did the party know? Did the party assent, by action? Was there something implicated?

We have had concerns about the NAIC model, because what it does is, it delineates specific instances where implied consent will be deemed, so that is taken away. For instance, payment of premium or something like that. If you go into court, however, you may be able to say, "I did not intend to do that." But it is automatically assumed under the model.

That is why anything short of written, express written consent, becomes unclear; and that is why that needs to be the standard.

Senator BRYAN. Ms. Griffin, I do not want to get highly technical here—and I never took a course in my life on insurance law—and so I am not educated in this.

But ordinarily, unless the terms of the consent would say, in effect, "And by so consenting, I hereby agree to relieve the former obligor of his or its liability," mere consent alone does not extinguish the liability, under the common law. Both remain equally liable.

You may, obviously, by the terms of the transfer, effect a novation in which there is a substitution of liability, generally, under contract law.

Again, help me a little bit. I understand what you are saying about the ambiguity that may adhere in consent; but if there is a consent alone, without the express agreement on the party of the insured, does the consent alone—let us assume we have a consent.

Let us assume Mr. Eliades consented to the transfer—he clearly did not—but that the consent did not say, "I hereby agree to relieve the original insurer of its obligation to me." What would the law be, then?

Ms. GRIFFIN. I think that would definitely depend on the particular court; but I understand what you mean. Because mere consent alone, without the intention to release the obligation, is not sufficient.

But my understanding would be, if there is an instrument that is specifically said, "I consent to this transfer from Company A to B," that that would probably be enough to show the intent to release the obligation.

But, anything short of that is totally a question for the factfinder. It is a case-by-case determination; and consumers really cannot predict what may happen in the court. That is why, again, I go back to this—express consent will provide a real level of predictability.

Senator BRYAN. I do understand that you can have the litigators' full employment act by, you know, what act or inaction constitutes consent; and that is something that is clear, from the testimony.

Mr. Foster, under the model act that you all have, does it require the insurance commissioner to make an affirmative finding that the transfer is in the best interest of the insured?

Mr. FOSTER. Yes, sir. The model act has standards that will give guidance to the insurance commissioner.

Senator BRYAN. I know you may have some standards; but does, in effect, the standard require a conclusion on the part of the insurance commissioner that "the transfer is in the best interest," or at least, "the insurance commissioner believes?"

Mr. FOSTER. That is correct. We would have to come to that conclusion, that it is in the best interest of the policyholder.

Senator BRYAN. And under the model act, notice is required, as I understand from the testimony here. What is the form of that notice?

Mr. FOSTER. It is not that dissimilar from the notice that would be required in the Federal law. Now, there are certain things that—for example, we have a 2-year, 24-month to notice; and yours goes beyond that, obviously.

Senator BRYAN. So, this is a written notice?

Mr. FOSTER. That is correct. And it would include, as I recall, 5 years of financials; 5 years of at least two rating service ratings; 3 to 5 years, I forget which it is, specifically, of the company's balance sheet that the company is going to, and the one that, the ceding carrier.

It is all meant to be—frankly, we tried to strike a balance at the NAIC committee, of providing enough essential information to the policyholder, without overkill or sending so much information that a typical policyholder—and we all, unfortunately, have to attempt to put ourselves in that person's shoes. How much is too much? And how much is essential?

And so, we tried to strike balance; and there were no negotiations between the NAIC and ACLI. I must have missed that, because I was involved for 2 years.

We had public meetings; we took public comment. Ms. Cobb and others sent letters to our task force. We considered those letters. We got a letter from Senator Metzenbaum and others.

In the end, we tried to weigh in the balance how much the policyholder needed to get, and ought to get, to make an informed decision; and I think we struck a reasonable balance. That is not to say it is perfect, or not to say that we should not add something here or there.

Senator BRYAN. Mr. Foster, what type of consent does the model act contemplate?

Mr. FOSTER. Like your Federal bill, express consent.

Senator BRYAN. Express consent. So, the consent must be in writing, I take it?

Mr. FOSTER. Well, it has got to be express. It is clear in the two notices that you got the right to reject the transfer, much in the same way and in similar language; the Federal bill is along the same lines.

Senator BRYAN. Let me press you forward here. Staff has just provided me with a copy of the notice requirement under the model act.

At least, under our numerical structuring, it is on page 3 of the notice requirements. I do not know whether ours if paginated with your own listing.

But again, it does not appear to me just in a cursory reading of this that, in fact, express written consent is required. Direct my attention, if you will, Mr. Foster.

Mr. FOSTER. In the same way, nor does your Federal bill require this consent.

Senator BRYAN. And I am not suggesting what we have crafted is a model to be held out to the world. There may, indeed, be some adjustments that have to be made with respect to some clarification and some concerns, frankly, that are practical impediments that we may want to take a look at.

So, yours then, does not require an express written consent?

Mr. FOSTER. Let me respond to that, because I know the person sitting on either side of me took the position then—and probably they may still today, I do not know—but Ms. Griffin and Mr. Hunter at that time, and others, suggested anything short of outright positive consent was not enough for consumers.

That weighed very heavily on me and, I know, other commissioners on that task force. What should we do, to be acting in the best interest of policyholders? And certainly, there was unanimous agreement from Day One, that no Virginia resident, Texas resident, any resident, should ever find their contract transferred to an unlicensed carrier in their State, and risk guaranty fund coverage being jeopardized.

In the same way, no contract should ever be transferred, without notice given and some kind of opportunity for the policyholder to consent expressly to it.

We did end up coming down on the point of stopping short of positive consent; because I believed then, and I believe today, positive consent would prohibit and eliminate assumption reinsurance agreements. I could not bring myself to conclude that, as State insurance regulators, I should be recommending to my Legislature that it should be contrary to public policy for insurance companies to transfer blocs of business.

I believe that it was appropriate, so long as it was proper and looked after consumers; and as long as the insurance commissioners office, now Commissioner Hunter's office, and others looked at it, applied it against standards, and say, "You have to have some provision for consent. You have to publish information to the policyholder. And, in the end, the insurance commissioner is going to review it."

And I think that is important to a resident of Texas, if he gets, in his package, an indication that Commissioner Hunter's office has looked at it. I would rather go with that route than I would an outright prohibition.

Senator BRYAN. Well, let me just tell you what troubles me about the approach. Our legislation—and I am not suggesting that it is a model—but our legislation breaks it down into two categories.

And it says, first, there shall be a category of prohibited transfers, and says that it requires express consent. That is the premise.

And then we go into an area that will be, perhaps, more troublesome for Ms. Griffin, and Mr. Hunter has raised some concern, in which we describe circumstances in which that consent can be implied. And among those would be a length of a period of time.

But the premise is that it requires express written consent. I do not find that in the model act, and if I am misreading that, please share it with me.

Mr. FOSTER. No, it is not in the model act; nor do I find it in your statute.

Senator BRYAN. Let me read it: "Except as provided in subsection B, no insurer shall enter into a transfer agreement, or transfer a contract of insurance pursuant to a transfer agreement, without the written consent of the policyholder or beneficiary of the policyholder."

Now, that is the primary predicate. I recognize——

Mr. FOSTER. But then, read section B, Senator. It then sets out the same kind of——

Senator BRYAN. Yes, I understand that. But the philosophical approach is quite different. I mean, what we are saying in the first instance, there should be written consent. Then, "We recognize that there are circumstances under which the law can imply consent."

Mr. FOSTER. Well, I am not sure the average policyholder gets the benefit of these five lines in Federal law when, in the end, the result is the same. The result is, their contract may be transferred, if they fail to object.

Maybe I just have not focused on the importance that a policyholder in Virginia may place on those five lines in the Federal law; when, in the end, there are clear exceptions in the next section.

Senator BRYAN. I would simply say I find some ambiguity in the approach. I find some concern about that, and the exceptions I think are clearly in a different context as I find them in the model act. But let me not belabor the point, because we have got another hearing.

Mr. Hunter, you have indicated some things that you find about the proposed legislation that you feel that we ought to take a look at and to correct, and we can pursue that perhaps in follow-up writing.

Specifically, in addition to the fact that there is no assurance that the model act will ever be passed by all the States—I think all of us understand that that is a matter up to each State legislature, and they can take what parts they want and discard what parts they want or simply reject it and say we have got something we like better—encapsulate for me your primary concern with the substance of the model act. Aside from the fact that it is not uniform in the sense that it can compel all States, what would be the two or three items that give you the greatest amount of heartburn?

Mr. HUNTER. I think I tried to list them in the testimony. First of all, the purpose of the NAIC Act it says is to provide for the regulation of the transfer and novation of contracts of insurance by

way of assumption reinsurance, compared to the purpose of your act, which is to prohibit the transfer and novation of a contract of insurance without the prior informed written consent of the policy-holder. That is the basic difference.

Senator BRYAN. Yes.

Mr. HUNTER. And I am hearing the debate about whether you actually accomplish that, but if your intent is going to be carried out, then that is what I think should be the intent that should be carried out. And then there were some technical things about numbers of ratings and so on that I have listed in my testimony, but that is the essence.

Mr. FOSTER. Mr. Chairman, could I comment on Mr. Hunter's answer there, because I have got concern that Virginia and other States have enacted State legislation, and now if you adopt this Federal legislation it has been suggested by some of the aides to the authors that this is going to be self-enforcing, that we should not expect the Department of Commerce to issue regulations, that the only benefit to be derived by Virginia policyholders is the right to go to Federal court and sue.

Well, I can tell you, I offer that comment frequently, more frequently than I like, to policyholders. And I say I am sorry, I cannot help you with your dispute, it is a contractual dispute, go to your local court. I normally remove the telephone this far from my ear where I hear from them as to what they think about my suggestion that the law allows them to hire a lawyer and sue.

So, my concern—although I cannot suggest for a moment that 50 States in lockstep will adopt this model act, I know States are adopting laws based on the model act. And I have grave concerns about any Federal bill—and this is where Commissioner Hunter and I just disagree—that would possibly supersede my State law or would create a chaotic situation where there is a Federal laws on the books with no enforcement.

The suggestion that the industry would police themselves and enforce it against themselves, or even that I would be asked to enforce a Federal law; I am removed to Federal court enough as it is, by ERISA, by the Risk Retention Act, and other places where Congress, in some effort to address a problem, has preempted State regulation. So, my only point is to please do not put us in that kind of position here.

Senator BRYAN. Mr. Foster, I take it that your concern might be ameliorated to some extent if you were given the power to enforce the provisions? We do that, for example, in a number of statutes. That is not uncommon. I am working on a telemarketing fraud piece of legislation that has passed out of this committee, it has passed out of the Senate, in which we give the attorney generals of the respective State the power to enforce the provisions as they deal with telemarketing fraud. We even provide some venue options.

Mr. FOSTER. That is certainly preferable to a Federal agency being named and then not enforcing it. I cannot dispute that.

Senator BRYAN. I understand the concern. I think you make a valid point there.

Mr. Mica and Mr. Minck, before we conclude, Senator Metzenbaum questioned you quite extensively; I would not want you to think that I am neglecting you here in not raising a few questions.

Let me understand, what is really the objection if you agree that policyholders ought not to be left in the position of Mr. Eliades? I mean that is an absolutely compelling story beyond any question of a doubt. That, I mean, nobody in America ought to be left in such a situation that this gentleman was. We can find no culpability in the way in which he handled his business relationship with the original carrier that he acquired. He had no knowledge of the transfer, he fell into a situation in which he was in necessitous circumstances, and now he seeks the benefit of his bargain and he has gone through all of this and 6 years later, or whatever it is, you still have not gotten a dime.

Now, that is something that, frankly, I am sympathetic to.

Mr. MINCK. Senator.

Senator BRYAN. Yes.

Mr. MINCK. I think there is nobody I know that would not agree with what you just said. And, in fact, the parts that we have been addressing—and there has been unanimity between us and the NAIC—it has been the need for there to be proper information given to anyone in his position before contracts are transferred, an opportunity to say no if they do not want them; certainly an opportunity to say yes if they want to go to the other company.

And then there comes the question of what do you do with the large number of people who do not respond to written solicitations, whether they come from insurance companies or anyplace else in the world. And it is that, and that is a very real thing, that we are concerned about. And we want to have a situation where if, for example, an individual does not respond to say yes or no but pays premiums for 2 years, say 24 monthly premiums, we can go ahead on the assumption that, in fact, he is satisfied and that he is covered now by the company.

We want to bring these things to closure. We also want to be in a situation where if a group case transfers and there are, say, 500 employees and the employer says yes, we do not want to be in a situation where we have to get 500 yeses from each of the employees, and if they just do not respond then it is not effective.

Senator BRYAN. Mr. Minck, there may be some basis to accommodate some of those concerns, but I must say I think Mr. Hunter makes an argument that is pretty strong. There is no assurance, notwithstanding—let us assume your best of attention and your advocacy in each of the respective States, that this is going to be enacted in every State.

Now, why should policyholders in those States who do not have such provisions as Mr. Foster and his colleagues have put together in this model act, why should they be left in a disadvantaged situation when we can solve that by enacting a statute which provides for notice, requires an express consent?

Try to work out with you those technical concerns that I think there may be some common ground to come down on, the group policy coverage. I understand what you are saying there. I would want to take a look at that. I think you may make a point there.

But I do not understand why there is this aversion to doing something that has a uniformity across the country.

Mr. MINCK. Well, again, we are not averse to uniformity across the country. And, in fact, I think you will find that in order to get something accomplished in a business like ours, you do not need 50 States to have the same rules. Companies will comply with the rules as soon as they are in effect in a large number of States. You have to, to operate something of this sort.

But our problem is seriously along the lines that Commissioner Foster pointed out. We think that many of these situations are emergency situations where there is a regulator who is attempting to save a company or do other things, and we think that you cannot have diverse centers or different people administering it.

One of the, again, examples that I referred to earlier of a company that was being rehabilitated, and the sale through one of these contracts of a very large block of business to everybody's benefit; if the commissioner who was doing that had had to get approval from the Department of Commerce, I think much of the value of the stuff that was being sold would have vanished. We just very much feel that it ought to be the States who are regulating it as part of their overall regulation.

Mr. MICA. Also, Senator, I might add that—at least expressed to me as I was preparing to come up here from some of our member companies, is that the idea of selecting one paragraph or one sentence of company operations, pulling it out and enforcing it at a Federal level in a vacuum with everything else does create some concerns, just operational concerns.

Legitimate concerns that here is an agency that would be given the authority to do only this in this area, the Department of Commerce, when there are others in the Congress who say that this part of the business should be regulated and overseen by the SEC, this part by FTC, the other part by the Justice Department. You get into a situation where there is almost no end to it. So, there are legitimate concerns about how you can operate.

Senator BRYAN. Well, I guess, Mr. Mica—I do understand what you are saying. You are talking about a balkanization of the regulation process, I understand those concerns. But, I mean, we deal with those in other contexts by saying, in effect, look, here is the Federal standard. You know, if the State enacts measures that are equal to or greater than that and are certified, then in effect the enforcement mechanism is left to the State level.

Now, this may not be a model enforcement, but that is OSHA, that is the way OSHA is handled for example. And I am not here to defend every promulgated regulation or the enforcement, but conceptually it is a Federal standard and we say that, look, if the State certifies that it will adhere to that standard, give even flexibility to go further, then, in effect, that authority is delegated to the State level.

You do not deal with the Federal enforcement concept, you deal with the State OSHA regulator, you deal—within the context of this legislation, you deal with Mr. Foster, Mr. Hunter, their colleagues in the respective States. I mean that, then, it seems to me, addresses the concern that you have about many different jurisdictions involved in regulating your industry.

Mr. MICA. Senator, I do not mean to make light of it, but if I go back and tell my folks it is going to work like OSHA, I am in trouble.

Senator BRYAN. And I understand that.

Mr. MICA. They are going to give me a hard time.

Senator BRYAN. That in terms of the substance of the content.

Mr. MICA. I understand.

Senator BRYAN. But, I mean, in terms of the concept, I mean we do that frequently at the Federal level, to provide that.

Well, gentlemen and ladies, we thank you very much for being here. This has been a most informative hearing and we look forward to working with you and your colleagues in the industry, the private sector, the consumers, and obviously the victims of America. Thank you very much. We stand adjourned. [Hearing recessed at 4:10 p.m. and reconvened at 4:15 p.m.]

Senator BRYAN. The subcommittee will now convene. This part of this afternoon's hearing is devoted to an examination of the issue of insurance company redlining.

"Redlining" is defined as the refusal by insurance companies to service individuals in communities either because of race or residential location. Consumer and civil rights organizations allege that redlining is widespread among minority communities. They further allege that companies are engaged in a number of discriminatory practices, including employing higher underwriting standards or the outright refusal to service in minority communities. Insurance industry representatives, on the other hand however, deny these allegations and suggest that companies' underwriting activities are based on risks and other business decisions.

While there is no specific legislation that is presently before the committee, I have scheduled this oversight hearing this afternoon to ensure that the issue is thoroughly examined. Although the Commerce Committee staff has been involved in discussions with various interest groups over the last several months, this is the committee's first official proceeding on this issue and we have testifying before us today a number of witnesses who will offer some instructive insights into this issue.

Joining us first is our colleague from the State of Wisconsin who has established himself as a real leader in this issue, offering legislation; testifying, I believe, before the Banking Committee. And I am delighted to welcome him today and to receive his comments to be made a part of this official record.

Senator Feingold, welcome, and I apologize to you that we fell behind schedule, largely because Senator Metzenbaum's and my questioning took longer than we needed to. But we appreciate your patience and forbearance, and are delighted to hear your testimony.

STATEMENT OF HON. RUSSELL FEINGOLD, U.S. SENATOR FROM WISCONSIN

Senator FEINGOLD. Thank you very much, Mr. Chairman, for your courtesy and for holding this hearing on the problem of discrimination in the determination of who has access to affordable, high quality insurance in America, a practice that we all better know as insurance redlining. Your interest in this subject and your

continued leadership and concern about the issues that affect our Nation's consumers as chairman of the committee's Consumer Subcommittee is much appreciated, and I look forward to working with you on this issue, Mr. Chairman.

During this hearing the Senate Commerce Committee will gather testimony from a diverse group of individuals and organizations that will describe the extent of the lack of access to affordable, quality insurance. Of course, this testimony will only reaffirm what many of us in this room have known for some time. That is because we already have three decades of research, studies, and reports compiled on this subject which have again and again reaffirmed the extent of the problem of insurance redlining.

It is not only disturbing that discrimination continues to exist today, but it troubles me even more, Mr. Chairman, that our great city of Milwaukee, WI has received national attention regarding this problem. In fact, a CNN television report stated that Milwaukee is becoming not only famous for beer, but for insurance discrimination as well. This is something we want to change.

Senator BRYAN. The former you accept, the latter you reject I am sure.

Senator FEINGOLD. That is correct, Senator, Yes. [Laughter.]

To address this problem, I introduced S. 1917, the Anti-Redlining and Insurance Disclosure Act of 1994, which would require insurance companies to disclose information regarding where they write property insurance. The bill is patterned after the reporting requirements that are already required of banks and thrifts under the Home Mortgage Disclosure Act.

There are three components which S. 1917 includes which I think are critical if we are going to have any meaningful measure designed to address the problem of insurance redlining. I will just make a very quick statement about each of those three points.

Senator BRYAN. Go right ahead.

Senator FEINGOLD. First, it is important that any data collection and reporting requirements on insurance costs and policies be done at the most detailed level which is reasonably feasible. For example, I happen to think it is preferable to require reporting by census tract rather than ZIP code, since it allows for more detailed detection and analysis.

Second, and perhaps most importantly, the collection of data on insurance losses and claims should also be included in any insurance disclosure initiative. The importance of such data was highlighted by the recent compilation of data comparing low-income minority areas with low-income white areas collected from insurers in St. Louis and Kansas City by the Missouri Department of Insurance, which showed that low-income minorities, on average, paid higher premiums for homeowners' insurance than white homeowners of similar means for comparable coverage even though, Mr. Chairman, the losses were lower in the minority areas. Without this data, we may not be able to adequately resolve whether or not claims that disparate treatment of certain neighborhoods are justified by greater claims and losses.

Finally, Mr. Chairman, and third, since the collection and disclosure of such data will provide affected individuals and Federal and State regulators valuable information necessary to enforce our Na-

tion's antidiscrimination laws, it should be made available to the greatest number of communities and individuals as possible.

Although the bill only applies the data disclosure requirements to a limited number of property insurance lines such as homeowner's insurance, I also recognize the problem and the need to impose similar disclosure requirements on automobile insurance practices. The principles that I briefly mentioned before apply equally to any legislation designed to address the availability of affordable quality automobile insurance, especially in light of the recent studies and the lack of access to such insurance for many Americans.

I am encouraged once again to see two Members of the House of Representatives appearing before a Senate committee on this issue. Of course, I am referring to Representative Collins and my good friend Representative Joe Kennedy, who really is the reason I got involved in this issue. He helped us put together a hearing in Milwaukee to highlight it, and my bill is really a reflection of the work he started in the House, in the hope that the Senate can hold up its part of the bargain on trying to deal with this problem.

It is my hope that we can all work together and build upon the important advances that both of these people have made and contributed to bring to national attention and focus to these practices. It is important that we not waste all of their efforts and the momentum they have provided to this issue, and it is critical that we all make a concerted effort to enact the most stringent legislation possible during the 103d Congress.

So to conclude, I want to thank the chairman of the entire committee, Chairman Hollings, and the chairman of the subcommittee, Chairman Bryan, for holding this hearing, and I look forward to working with them and the other members of the committee and the whole Senate, to try to finally address this problem.

[The prepared statement of Senator Feingold follows:]

PREPARED STATEMENT OF SENATOR FEINGOLD

Thank you Mr. Chairman, for holding this hearing on the problem of discrimination in the determination of who has access to affordable high quality insurance in America—better known as the practice of insurance redlining. Your interest in this subject and your continued leadership and concern about the issues that affect our nation's consumers as Chairman of the Committee's Consumer Subcommittee is much appreciated. I look forward to working with you on this and other important issues.

During this hearing the Senate Commerce Committee will gather testimony from a diverse group of individuals and organizations on a subject that strikes at the core of the ability of many Americans to participate fully in our society by being able to enjoy that which has come to be known as a significant portion of the "American dream"—home ownership.

Three decades of research, studies, and reports have reaffirmed the extent of the problem of insurance redlining that prompted the 1968 National Advisory Panel on Insurance's description that "Communities without insurance are communities without hope" as well as the inadequacy of state and federal responses to address it. These studies, as well as testimony and evidence gathered before both the House Banking and Energy and Commerce Committees, thanks to the efforts of both Representatives Joseph Kennedy and Cardiss Collins, have indicated that hundreds of thousands, if not millions, of individuals and entire neighborhoods continue to be denied or provided inferior insurance coverage and that insurance redlining practices are currently widespread throughout the United States.

It is not only disturbing that discrimination continues to exist today, but it troubles me even more so that the fine city of Milwaukee, Wisconsin, has received national attention regarding this problem. In fact, a CNN television report even stated

that Milwaukee is becoming not only famous for beer, but for insurance discrimination as well.

The disturbing results concerning the occurrence of insurance discrimination released just two weeks ago by the' National Fair Housing Alliance, which revealed widespread insurance discrimination in minority neighborhoods in the four cities examined, including Milwaukee, only adds to this reputation. For me, the implications of these results are simple it is time for us to act and do all that we can to prevent the shameful practice of insurance redlining.

Some will argue that the disparities in the access to and availability of insurance are solely based on principles of economics and statistically based risk assessments—and not on principles of prejudice. Sadly enough, it appears that this is not always the case. Take the words of an insurance company district sales manager from Milwaukee, who was recorded as telling his agents:

> "* * * I think you write too many blacks * * * You gotta sell good, solid premium paying white people * * * They own their homes, the white works. * * * very honestly, black people will buy anything that looks good right now. * * * But when it comes to pay for it next time. * * * You're not going to get your money out of them."

This "quit writing all those blacks * * *" prejudicial policy was not only communicated to agents verbally, but was placed in writing as well. And it has been reported that the manager even showed one agent how to accomplish this goal by stating that:

> "If a black wants insurance, you don't have to say, just tell them, because based on this kind of policy, the company will only allow me to accept an annual premium. Do it that way."

Activity of this type that has prompted such allegations of discrimination in the insurance industry cannot and must not be tolerated anywhere in our society.

To address this problem, I introduced S. 1917, "The Anti-Redlining in Insurance Disclosure Act of 1994", which would require insurance companies to disclose information regarding where they write property insurance, patterned after the reporting requirements already required of banks and thrifts under the Home Mortgage Disclosure Act. This information would allow members of the public, regulators, the insurance industry, and Congress the means to identify the extent of the problem and would assist affected individuals and federal and state agencies efforts at enforcing our nation's anti-discrimination laws.

There are several components which S. 1917 includes which are critical for any meaningful measure designed to address the problem of insurance redlining.

First, it is important that any data collection and reporting requirements on insurance costs and policies be done at the most detailed level which is reasonably feasible. For example, it is preferable to require reporting by census tract rather than zip code since it allows for more detailed detection and analysis, as census tract populations are much smaller and homogeneous than many urban zip codes which often contain neighborhoods that have a diverse range of economic, racial and housing stock characteristics, thereby resulting in a "masking" effect for purposes of statistical analysis. The census tract reporting standard that is required of the banking industry under the Home Mortgage Disclosure Act should be applied to the insurance industry as well. S. 1917 takes this approach.

Second, and perhaps most importantly, the collection of data on insurance losses and claims should also be included in any insurance disclosure initiative. Such data would be essential for any proper analysis necessary to resolve disputes that arise involving claims that disparities in the price of insurance between different neighborhoods or groups of people are solely based on loss experience and the associated risk involved rather than prejudice.

The importance of such data was highlighted by the recent compilation of data comparing low-income minority areas with low-income white areas collected from insurers in St. Louis and Kansas City by the Missouri Department of Insurance, which showed that low-income minorities on average paid higher premiums for homeowner's insurance than white homeowners of similar means for comparable coverage, even though losses were lower in the minority areas. Without this data, we may not be able to adequately resolve whether or not claims that disparate treatment of certain neighborhoods are justified by greater claims and losses.

Third, since the collection and disclosure of such data will provide affected individuals and federal and state regulators valuable information necessary to enforce our nation's anti-discrimination laws, it should be made-available to the greatest number of communities and individuals as possible. S. 1917 would require that data be collected in 150 Metropolitan Statistical Areas.

I am also interested in exploring whether or not the insurance industry should be required to meet the same requirements that are imposed upon the banking in-

dustry under the Community Reinvestment Act. To that end, S. 1917 calls for a study which would review the feasibility of creating reinvestment requirements for insurers similar to those already applied to depository institutions.

Although S. 1917 only applies the data disclosure' requirements to a limited number of property insurance lines such as homeowners insurance, I recognize the problem and the need to impose similar disclosure requirements on automobile insurance practices. The principles that I briefly mentioned before apply equally to any legislation designed to address the availability of affordable quality automobile insurance, especially in light of the recent studies on the lack of access to such insurance for many Americans.

It is important that we place people of all races and ethnic backgrounds on a level playing field when it comes to the opportunity to purchase all types of insurance—including both homeowners and automobile insurance. It is difficult enough these days to be able to afford to buy a home, and almost impossible to purchase one without homeowners insurance.

It is also a reality today that in order to obtain a job which pays enough for an individual to save an adequate amount of money to buy their own home, one must often travel a great distance away from their own neighborhood—often to a distant suburb where all too often most good paying jobs are now being exclusively located. Without affordable automobile insurance, access to even these opportunities are essentially denied.

I am encouraged once again to see both Representative Collins and Representative Kennedy prepared to testify before a Senate Committee on the nature of the insurance redlining problem and the need for Congressional action to address it. It is my hope that we can all work together and build upon the important advances that both of them have contributed to bringing national attention and focus upon these practices. It is important that we not waste all of their efforts and the momentum they have provided to this issue, and it is critical that we all make a concerted effort to enact the most stringent legislation possible during the 103rd Congress.

In conclusion, I would like to again thank both Chairman Hollings and Senator Bryan for holding this hearing and look forward to working with them both and other members of this Committee and the Senate towards addressing the problem of insurance redlining.

Senator BRYAN. Thank you very much, Senator Feingold. Let me assure you that this subcommittee is pleased to work with you. And I know you have a busy schedule, but I would invite you to join us here if you are able to stay, and give you an opportunity to visit by way of any questions you have of our distinguished panel.

Senator FEINGOLD. Thank you, Mr. Chairman.

Senator BRYAN. I note that we have been joined by the distinguished Representative from the Eighth District in Massachusetts, who chairs the Consumer Credit and Insurance Subcommittee in the House, previously referenced here by Senator Feingold's testimony, a friend and one that we have an opportunity to work with on a number of issues and are continuing to work on a number of issues that we are both very interested in, and hopefully we will be able to reach a successful and satisfactory conclusion in this Congress, the Honorable Joe Kennedy. Joe, it is nice to have you here with us.

STATEMENT OF HON. JOSEPH P. KENNEDY II, U.S. REPRESENTATIVE FROM MASSACHUSETTS

Mr. KENNEDY. Thank you so much, Senator Bryan. I want to particularly thank you for the tremendous leadership you have shown on a range of issues involving consumer interests in this country. Your leadership on interests of consumers, particularly with regard to matters over the fair credit reporting, have been unparalleled, and your ability to find ways to get legislation fashioned I think is a tremendous tribute to your service to our country.

And I thank you so much for your interest not only in those consumer issues, but in one that is much more insidious perhaps. It is never seen, but it is felt by millions of Americans across our country, and that is the issue of insurance redlining. This is an important hearing, and I thank you so much for your willingness to investigate this. We are in the process of getting legislation passed on the floor of the House, and we would love to see legislation passed over here in the Senate this year as well.

I want to say that we applaud the committee's decision to look at this very serious problem of insurance redlining. In today's financially complex world, insurance is a cornerstone of opportunity. Without insurance, a consumer cannot get a loan. Without a loan, that consumer cannot buy a home or start a business. And without the ability to buy a home or start a business or to acquire other assets, the consumer is trapped in a world not only of the lack of opportunity, but in complete despair.

Mr. Chairman, I would ask if I could just submit my statement to the record and just talk with you about my observations on this issue.

Senator BRYAN. That will be the order. It will be made a part of the record, and I note that the Congressman has a vote coming up shortly so I know it has to be abbreviated, but you take it in any order that you want and when you have to leave we understand.

Mr. KENNEDY. Thank you very much, Mr. Chairman,.

[The prepared statement of Mr. Kennedy follows:]

PREPARED STATEMENT OF MR. KENNEDY

Thank you, Chairman Hollings, for inviting me to participate in today's hearing. It is an honor to appear before you and the other members of the committee this afternoon.

I applaud the committee's decision to look at the very serious problem of insurance redlining. In today's financially complex world, insurance is a cornerstone of opportunity. Without insurance, a consumer cannot get a loan. Without a loan, that consumer cannot buy a home or start a business. And without the ability to buy a home, start a business, or acquire other assets, the consumer is trapped in a world not of opportunity, but of despair.

Most of us are lucky enough to find the insurance we need to lead secure lives. But throughout the country, millions of people are being denied reasonable insurance for reasons having nothing to do with the risks they pose, but having everything to do with their race, their wealth, and their neighborhood. The civil rights revolution that transformed our schools and workplaces has yet to penetrate the fortress that is the insurance industry. There Jim Crow is still laying down the law—separate and unequal. It's wrong, it's Un-American, and it must stop.

Mr. Chairman, if you're African American, or Latino, or Asian, or gay, then Nationwide is not on your side, you're in no hands with Allstate, and unlike a good neighbor, State Farm is not there. Let's just look at some of the facts that the subcommittee which I chair found over the course of 4 hearings and ongoing investigations:

• The California Insurance Group gave maps to agents that crossed out in yellow ink the African-American, Hispanic, and gay neighborhoods of San Francisco. The company deemed those areas off-limits for purposes of writing policies. California's Insurance Commissioner, John Garamendi, sued the company for unlawful discrimination. Ultimately, he reached a half million dollar settlement, and won a commitment from the company to increase its business in minority communities by $3 to $4 million over the next 4 years.

• Two weeks ago, the National Fair Housing Alliance announced that it would press charges against Allstate and Nationwide for discrimination in 4 major cities. The Alliance found dramatic evidence of discrimination. In Chicago, for instance, testers found evidence of discrimination in 95 percent of cases examined. And in Atlanta, where the eyes of the world will be focussed two years from now during the Olympics, only 2 of Nationwide's 155 offices are located in or near a minority area.

In Wisconsin, where the subcommittee held a hearing earlier this year, the NAACP has recently filed suit against American Family Insurance Company, the state's largest underwriter of homeowner's insurance, for redlining minority areas of Milwaukee. One of the company's sales managers was caught on tape making the following statement—and I quote: "Very honestly, I think you write too many blacks. * * * you gotta sell good, premium-paying white people. * * * very honestly, black people will buy anything that looks good right now * * * but when it comes to pay for it next time * * * you're not going to get your money out of them. * * * the only way you're going to correct your [performance] is get away from the blacks." The agent who was the focus of those comments was later fired.

Mr. Chairman, I'm sure you've heard insurers tell you, as I have, that urban homeowners are adequately served by state-sanctioned F.A.I.R. Plans. In limited instances that may be so. But F.A.I.R. Plans are too often poor substitutes for private insurance. Instead of pooling truly high-risk homeowners, they have become dumping grounds for everyone living in the city, including the people who are good risks—the people who live in solid neighborhoods and who take care of their homes. And F.A.I.R. Plans require people to pay more in premiums for less coverage. A recent study by the community group ACORN shows that urban and minority consumers are paying as much as 270 percent more for F.A.I.R. Plan coverage than they'd pay for equivalent private insurance. F.A.I.R. Plans aren't fair; they're a rip-off.

You have probably also heard insurers say that they can't insure urban residents because losses there are too high. Again, the evidence suggests that this may be a flimsy excuse. Missouri's insurance commissioner analyzed 12 years worth of data collected in white and black areas of St. Louis and Kansas City. The numbers show that residents of low-income black areas pay more for homeowners insurance and get less coverage than whites of the same income, even though their losses are less than those of whites.

All in all, Mr. Chairman, the record suggests a nationwide pattern of discrimination by insurers against urban and minority consumers. I am pleased that H.U.D. and the Justice Department have begun to seriously examine the practices of the insurance industry. But more needs to be done. As the G.A.O. recently reported, we need more information about who is getting insurance, who's not, and why. and we need that information in as detailed a form as possible, including census tracts, race and ethnicity, and loss information. Banks and thrifts already produce this kind of data to comply with the Home Mortgage Disclosure Act. If lenders can do it, then so can insurers.

Such information will help us shine a light on industry practices, and expose the truth about redlining once and for all. Those who have nothing to hide have nothing to fear. Others will receive a much-needed prodding to correct indefensible practices.

Some of us may differ about how best to address the issue of insurance redlining. But I believe that most of us agree that there is a problem. We must work together to solve it. The Home Mortgage Disclosure Act and other laws have helped to eliminate discrimination in the banking industry. Now it is time to expand the fight for fairness to the insurance industry. The days of special treatment for the industry—whether it be exemption from antitrust laws or from accepted norms of equal opportunity—must end.

In closing, let me again thank you, Chairman Hollings, for having me here this afternoon. I would be happy to answer any questions, or provide any assistance to you as you continue to consider this critical issue. Thank you.

Mr. KENNEDY. This issue I think is a critical one because if we are serious about ever dealing with the ultimate problem of racism in America, we have to deal with the characteristics of racism that all too often surround, I think, the black and brown and yellow people of our country. In my own district, about 60 percent of my district is reasonably well off and is white, but 40 percent of my district is poor, black, brown, and yellow. In those minority portions of my district the fact is that people cannot own their own home, they cannot own their own small businesses, and the reason for that is quite simply the lack of insurance that is made available and the lack of banks that make loans in the poorest ghettos of every major city in America.

Now, if an individual cannot own their own home, or if they cannot own their own small business, it is very difficult for them to

build up assets or wealth. Without the ability to build up assets or wealth, the best schools in America are eliminated from the reach of their kids. The problem becomes a cycle of poverty that goes from generation to generation.

My sense is that the way that we can ultimately break the back of racial prejudice in America is to make sure that all of our institutions are doing their fair share, making certain that they are investing in the inner city of America, that they are not looking at redlining entire neighborhoods simply because of the geography or because of the race of the individuals that happen to live in a particular area.

And we have—just so much testimony has come before my subcommittee, Mr. Chairman, on the House side, of individuals involved with some of the biggest companies in America. The fact is that you are not in good hands with Allstate, and Nationwide is not on your side, if we look at how these industries actually operate. These companies eliminate whole groups of individuals from the ability to get insurance because of where they live or the color of their skin.

Agents have come before our committee and told us of specific racial slurs and slanders that have taken place. They have been told point blank that they are not allowed to write policies in minority parts of a service area. And in my own district, I had a small business that was in a white part of Dorchester, MA, a section of Boston. The fellow—he is white—moved his company into black Dorchester. He was told that his insurance was going to be canceled. He asked his broker why his insurance was canceled, and the broker said because I am not allowed to write policies in that part of the city of Boston.

These are the realities that take place. It is a reality that takes place in Los Angeles. We had an insurance commissioner, John Garamendi, come before our committee and show us maps that he had gotten from agents that demonstrated whole sections of the city of Los Angeles that are redlined.

Much of the insurance in this and other inner city areas is underwrittent by offshore insurers. In Los Angeles, for instance, most of the companies that were paying their insurance premiums in the inner city before the 1992 civil disturbances paid them on time, and yet when they went to collect on those insurance claims 80 percent of them were unable to collect because the insurance companies simply packed up their bags and left because there were so many concentrated losses, and because these were unregulated insurance companies operating in a State that cannot possibly stay on top of all the different companies that are there.

So, what we are trying to do is not come in with a whole series of regulations as to how the insurance industry ought to operate. All we are asking is for the light of day, for simple disclosure. Let us get these companies to just tell us the truth, tell us where they are writing policies.

And let us do it in the most detailed way we can. There is a great deal of controversy over whether we should do it by census tracts or whether we should do it by ZIP codes. The fact is that the insurance industry wants ZIP codes because they know that census tracts are the kind of specific data that will allow us to determine

which individuals are actually getting the policies written and who are not getting the policies written for them. If you take ZIP codes, you could mix data from wealthy white suburbs with that from poor black ghettos, and therefore you will get a very confused picture as to what is actually happening in the insurance industry.

We are just trying to get simple disclosure. With that disclosure, I think we can begin to know what our industries are doing. With that light, Mr. Chairman, I believe we can end any kind of potential discrimination that exists in that industry.

We need your help in the U.S. Senate. You have been a great friend of the consumers of this country, of people without a voice, and I look forward to working with you, Mr. Chairman, on this issue, and joining with you to make certain that we end the terrible scourge of racism that exists and make certain that there are no tendencies with regard to redlining in the insurance industry. And I thank you very much for the opportunity to testify.

Senator BRYAN. Let me just say that we appreciate very much not only your time here this afternoon, but the commitment that you have shown on this. This is not something, I know, that you take lightly, and I appreciate the passion with which you speak and the conviction with which you articulate your concerns, and we will look forward to working with you on this and many other issues. Thank you very much for joining us.

Mr. KENNEDY. Thank you very much, Mr. Chairman.

Senator BRYAN. Let us now for the record—I have been informed that Congresswoman Collins was unable to make it over to the hearing this afternoon because of a commitment in the other body, and without objection her statement will be made a part of the record as well.

[The prepared statement of Ms. Collins follows:]

PREPARED STATEMENT OF REPRESENTATIVE COLLINS

Mr. Chairman and members of the committee, I appreciate the opportunity to testify today on the important issue of insurance redlining, particularly before this committee, which has been such a leader in consumer protection. The timing is appropriate. I testified last July 1 on toy safety legislation, and that bill, with the strong leadership of you, Mr. Chairman, and Senators Gorton and Danforth, is now almost on the President's desk. Hopefully, in the next few months, we can also get an insurance redlining bill to the President's desk.

Over the last year, the House Commerce Subcommittee has examined redlining practices of insurance companies. At the subcommittee's two hearings, we heard very disturbing reports about a variety of practices insurance companies use to deny access to insurance to the residents of our urban areas.

Some may say that insurance redlining is a thing of the past, but the witnesses at our hearings testified that the practice continues. Some may say redlining doesn't exist, or thry're not sure it's a problem. I know it's a problem. My constituents know it's a problem.

For example, those at the hearing can't forget Selwyn Whitehead of the Economic Empowerment Foundation, who testified about her experience in trying to get liability insurance for her telecommunications consulting firm in the late 1980's. When she identified her firm as a woman-owned firm, of color, in Oakland, she was turned away or quoted premiums from $8,000 to $10,000 per year. But when she called on behalf of her fictitious white male boss, a Mr. Selwyn Whitehead, the first quote was for $1,200.

The statistics speak for themselves. Illinois Public Action testified that there are 52 State Farm offices and 32 Allstate offices in a predominantly white congressional district in Chicago. But in the Chicago portion of my district, according to Public Action, there are only six State Farm offices and two Allstate offices outside the downtown area. I would like to submit for the record the detailed study prepared

by Illinois Public Action, "An Analysis of Zip Code Distribution of State Farm and Allstate Agents and Policies in Chicago."

And ACORN testified that in Chicago, only 51.1 percent of occupied, single family units in low income neighborhoods, and only 57.6 percent in minority neighborhoods, were covered by any type of insurance, compared to 90.0 percent coverage in high income and 87.7 coverage in white areas.

And there is plenty of other evidence of redlining behavior by insurance companies. For example, the NAACP has a lawsuit pending against American Family Mutual Insurance Co. That's the case where the sales manager was recorded as telling an agent, "I think you write too many blacks. You gotta sell good, solid premium paying white people." The California Insurance Department recently entered into a $500,000 settlement with the California Insurance Group after the company was accused of redlining large areas of San Francisco. Other witnesses today will provide still more evidence of redlining.

As a practical matter, access to property insurance is a necessity for mortgage loans and is often essential for access to small business loans. Without access to affordable insurance, small businesses in our urban areas cannot prosper nor generate badly needed jobs. Similarly, access to affordable automobile insurance is often essential for residents of the inner cities to keep and hold jobs.

My constituents must suffer daily the indignities of insurance redlining. They want to start seeing some relief. We here in Washington can argue about the perfect bill. But my constituents want results. We can wait forever for State legislatures to pass the perfect bill—or even any bill. But the people in Chicago want results. We can argue about the perfect bill and let the clock keep ticking away. Maybe we can even wait until next Congress, or the Congress after that, in the hope of the perfect bill. But I fear the environment for good legislation will not be any better next year, and will likely be worse. But while we argue over the perfect bill, the people back home want results.

I urge this committee to begin the process of fighting redlining by supporting appropriate legislation.

["An Analysis of Zip Code Distribution of State Farm and Allstate Agents and Policies in Chicago," by Illinois Public Action, April, 1993 may be found in the committee files.]

Senator BRYAN. Our panelists on this issue are Robert Hunter, who is the Insurance Commissioner of the Department of Insurance, the State of Texas, Ms. Mary Griffin, who is the insurance counsel of the Consumer's Union, Ms. Lynn Schubert, who is the assistant general counsel of the American Insurance Association, Gerald Bell, the commercial lines specialist, National Association of Independent Insurers, and Deepak Bhargava, who is the legislative director of the Association of Community Organizations. Let me welcome each of you to the panel.

Mr. Hunter, I am told there may be a plane schedule, that we may be able to help out a little bit if we allow you to go first. If that is in fact the case, you can testify and excuse yourself. We all understand that. Welcome again, for the third time today. I think the State of Texas is getting its money's worth out of you, and we are as well.

This is efficiency which is seldom evidenced at the Federal level. I want to let you know that you have been a great part of contributing to that efficiency. Thank you, Mr. Hunter.

STATEMENT OF ROBERT HUNTER, COMMISSIONER, TEXAS DEPARTMENT OF INSURANCE

Mr. HUNTER. Thank you, Mr. Chairman. I certainly appreciate that, and appreciate your consideration of my flight problems. Thank you for the opportunity to discuss the need for a Federal reporting bill on the issue of insurance redlining. During the 1970's, when I was Federal Insurance Administrator under Presidents

Ford and Carter, we studied and documented the issue of insurance redlining in several studies.

Although the Federal Government acted to keep insurance in cities through the Riot Reinsurance Program, the problem of discrimination against certain parts of the Nation's cities has never been fully addressed. When, in the early 1980's the Riot Reinsurance Program was eliminated, the Federal role in protecting insurance consumers against redlining was also ended. There was study after study during the seventies that showed that redlining was an issue.

Lately, the issue has stirred back to life in the wake of the riots in Los Angeles, where so many people were found not to have insurance, and some of those, particularly businesses, had insurance with unlicensed companies that did not pay.

The stirring back to life is real in Washington, because HUD and the Justice Department are now actively looking at enforcing Fair Housing Act provisions against redlining, and the President has issued an Executive order to encourage such activity.

But we need action from Congress as well. We need a national data base from which we can draw conclusions about how redlining impacts America and, for the first time in history, have a baseline from which we can measure progress in serving the underserved.

The National Association of Insurance Commissioners has started a study, but only 23 States have agreed to participate. I think we need a national data base.

When I conducted a public hearing just a couple of weeks ago in Houston on the issue of redlining, I received a clearcut example of this problem. Habitat for Humanity, an organization which I am sure you know about, has 50 homes in Houston built for and with low-income citizens, using their sweat equity.

The new owners have worked on the construction and have learned a great deal about home maintenance and home ownership. These homes are quality risks, and the group of homeowners in Houston have made only one claim in the last 3 years, that being for a tree that fell in a storm.

Nonetheless, only one major insurance company, Texas Farmers, was willing to insure these homes. As a result, they have had to go to very high-priced, nonstandard insurers. I have supplied to the staff a transcript of the Habitat for Humanity's testimony, which I think is very telling.

This is not real underwriting. It has nothing to do with risk. It is the application of preconceptions about areas of the city, rather than the quality of the risk. These are quality risks.

So, when I urge action, including voluntary action by insurance companies to end redlining, I am not talking about social engineering, but I am talking about the use of sound business practices.

How do we begin to attack redlining? I think, as Representative Kennedy said, the essential first step is exposing the facts to the light of day. Insurance companies say there is no redlining. I think there is. I think there is a lot of documentation of it, but let us get the data on the table.

To solve the problem of redlining, all areas where consumers are being unfairly discriminated must be identified. This requires reliable data broken down into small enough pieces to see what is hap-

pening to specific neighborhoods, and other specific groups of consumers. I would point to the HMDA type of data that the banks must supply. That is the kind of data that is needed, and that data base has I think made real changes in the banking industry's attitudes and perception.

I have to say also, in the wake of the Houston hearing, the insurers have come to me and talked to me about their plans. Their eyes were, I believe, opened that there is a real problem. I just had some private meetings with them, and there was much "mea culpa" involved in that, and I think even the insurance industry is beginning to realize this is a serious national problem that needs resolution.

The kind of statistics we need are data about where people are writing, where they place their agents, what kind of claims do they have so that we can see whether or not the losses justify their not writing in certain places, and so on.

In Texas, we have begun our review of our ZIP code data that we do collect as part of the NAIC call. We ran some regression analyses. We found that in ZIP codes where auto insurance availability is two times worse than the State average—in other words, where it is harder to get auto insurance—the minority population also is twice the State average, and where insurance is written in nonstandard companies half as much as the State average—where it is easy to get coverage—the minority population percentage is also half, so there is a correlation there.

By the way, I should say rural risks sometimes have trouble getting insurance, and it relates to underwriting guides.

In Texas, 88 percent of the companies have age of home restrictions. In other words, if your home is older than a certain age, we will not write you no matter what the quality.

More than 90 percent have minimum coverage amounts. Often companies will not write homes valued under, say, $60,000, regardless of the quality.

Senator BRYAN. Would that exclude Monticello, Mount Vernon, and some other establishments?

Mr. HUNTER. Their age. Probability not the value, but certainly their age.

For example, there are several companies with $60,000 or higher restrictions—we will not write below $60,000—and Texas' median housing value is $42,500.

Now, this presents a problem, and as I say, it is also in the rural areas, so these underwriting guidelines have an adverse impact on the availability of homeowner's insurance for consumers in older or lower income, inner city, and rural neighborhoods.

As you doubtless know, there are two bills in the House pending before the Rules Committee on the subject of redlining, the Collins bill and the Kennedy bill, and I support the Kennedy approach.

In the Senate, Senator Feingold has a bill that is between the Collins and Kennedy approaches. I encourage you to look strongly at that bill. It actually is sort of the bill close to the bill that both Ms. Collins and Mr. Kennedy had before they went off in opposite directions.

I think that the draft of Senator Feingold is very good. I encourage you to add auto insurance to it. Currently, it covers only home-

owners. I encourage you to use census tract rather than ZIP code data to collect race and gender data and claims information and make that data publicly available so that we can start to shed the light of day on these things and move the country toward an end to this kind of discrimination.

Thank you very much.

[The prepared statement of Mr. Hunter follows:]

PREPARED STATEMENT OF J. ROBERT HUNTER

Mr. Chairman and Members of the Committee, I am pleased to appear before the Committee on the important issue of insurance redlining.

More than 25 years have passed since President Lyndon B. Johnson's Commission on Insurance Availability in Urban America, formed in the aftermath of Los Angeles rioting, told us that "communities without insurance are communities without hope." As Federal Insurance Commissioner, I ran the riot reinsurance and FMR Plan programs which sprang from that commission's studies. During the 1970s, we at the Federal Insurance Administration performed several studies documenting the fact that some insurers were avoiding certain neighborhoods. One of our reports showed that in New York City, residents were more likely to be denied homeowners insurance if they were black than if they had building code violations.

Today, we still find insurance companies making underwriting decisions based on all kinds of factors that have nothing to do with a statistically measured or measurable probability of risk. One of these factors, unfortunately, is your location on a city map that probably does not have any red boundary lines drawn on it but it might as well because the results are the same. I commend the members of this body who have decided to address redlining for their recognition—and rejection—of this antiquated form of underwriting and their determination to do something about it.

Definitions

In your study of this issue, you will hear and see the word "redlining" over and again. I think it behooves each of us to be clear about the meaning of this emotionally laden word when we use it.

My definition of redlining is simple. By redlining I mean unfair discrimination in the availability, price, benefits or quality of insurance for a class of consumers based on factors outside the control of the consumer. Redlining is not only geographic; it includes unfair discrimination based on race, gender, age, income level, value of home, age of home or other characteristics that the consumer cannot change.

By this definition, redlining occurs when a class of individuals is denied insurance, charged a higher price, provided fewer benefits or given inferior service for a reason unrelated to their risk or for a reason that is contrary to public policy.

Data indicate that unfair discrimination against several classes of individuals, particularly minorities and low income citizens, is practiced all too commonly in the insurance industry, denying many consumers the ability to purchase cars or homes or maintain small businesses. The Federal Fair Housing Act, as interpreted by the Supreme Court, is an example of the federal interest in ensuring that redlining does not prevent classes of consumers from purchasing a home. Denying insurance to citizens and small businesses in economically underdeveloped areas contributes to the web of inadequate economic opportunity and social decay. There was a television investigative report a number of years ago called "The Poor Pay More." We see the same result in insurance. The channeling of low-income people into high-risk, high-rate insurance companies is redlining.

I want to make it clear that I am coming at this problem not only as a state official with a consumer protection mandate and a personal history as an insurance consumer advocate. I also approach redlining as an actuary with experience in risk analysis and insurance loss projection. Underwriting standards that take a monolithic approach to neighborhoods, home value and age of home just don't make sense. They treat well maintained, structurally sound and burglar-resistant homes the same as fire traps.

When I conducted a public hearing on redlining in Houston on March 31, 1994, I received a clear-cut example of this approach to underwriting. Habitat for Humanity, an organization made internationally famous by former President Jimmy Carter, has built 50 homes for—and, of particular importance, with—low income families in Houston. This is sweat equity, and the new owners have not only worked on the construction, but learned a great deal about home maintenance. These homes and their owners are quality risks. This group of homeowners in Houston have

made only one claim—for a tree that fell during a storm. Nonetheless, only one major insurance company, Texas Farmers, was willing to insure these homes. A transcript of the Habitat for Humanity representative's testimony is shown as Attachment A.

The approach taken by other companies to the question of insuring these Habitat for Humanity homes was not genuine underwriting. Rather, it was the application of certain preconceptions about how people across the tracks live their lives and tend their homes. So when I urge action, including voluntary action by insurance companies, to end redlining, I'm not talking social engineering but I am talking the use of sound business practices that separate profitable from unprofitable insurance business one risk at a time.

Data Collection

How do we begin to attack redlining? The essential first step is to identify all areas that are being unfairly discriminated against in the availability, price, benefits or quality of insurance. To solve the problem of redlining, all areas where consumers are being unfairly discriminated against must be identified.

This requires reliable data broken into small enough pieces to see what is happening to specific neighborhoods and other specific groups of consumers. I would like to see data that tells what is happening in rural areas as well as in cities, and I would like to have urban data all the way down to the census tract level.

Certain lines of insurance—homeowners, automobile and small business commercial policies—are most susceptible to redlining, and those are the lines where the need for good, reliable statistical data are most crucial.

The kinds of statistics we need include data about service (including locations of insurance agents), coverages sold in an area, premium volume, prices charged and losses (including loss ratios).

Texas has been trying for more than a year to assess the degree to which redlining occurs in our state. We have used data calls, a consulting actuary's study and the more anecdotal route of public hearings. This is an ongoing effort to come up with the sometimes elusive truth about whether the industry does things its spokespersons deny it does. It is a pity that Texas has taken so long to identify the problem. It is doubly tragic that I must report that Texas is at the cutting edge of data analysis on this issue.

Evidence of Redlining—the Texas Experience

One place we looked for evidence of redlining was the placement of drivers in the Texas Automobile Insurance Plan (TMP), which operates as our state's assigned risk plan for drivers who have been rejected for coverage by insurance companies in the voluntary market. It is noteworthy that the TAIP offers only liability coverages, not comprehensive coverage that pays when cars are stolen or vandalized. Even if one assumes—as I do not—that low-income or high-minority neighborhoods are by definition high-crime neighborhoods, this should not be a reason for sending drivers to the TAIP.

Studies of TMP assignments in 1993 show that consumers who live in Zip Codes with predominantly low-income and minority populations are disproportionately insured through the TMP compared with those from Zip Codes with higher-than-average income and higher-than-average Anglo populations. Rural consumers also are disproportionately represented in the TMP.

TAIP assignments are one indicator of auto insurance availability in particular neighborhoods. Statistics gathered through this year's NAIC call to insurers writing auto insurance in Texas also showed a direct correlation between lack of availability and the ethnic and racial minority percentages of the population in the Zip Code. The data presented in Attachment B graphically portray the existence of auto insurance redlining. The data show that the higher the minority population in a Zip Code, the worse the auto insurance availability. In addition, lower availability of auto insurance correlates with lower median household income in a Zip Code.

- In Zip Codes where auto insurance availability is two times worse than the state average, the minority population percentage in the Zip Code also is twice the state average; and
- In Zip Codes where auto insurance is written in non-standard companies half as much as the statewide average, the minority population percentage is also half the statewide average.

The data also show a strong correlation between low median household income and low availability of insurance. I can supply a copy of these data in full Zip Code detail to this Committee if you desire it.

The Texas Department of Insurance is doing a similar analysis of homeowners insurance by Zip Code, but we do not have any preliminary results at this time.

I cannot overemphasize the importance of gathering thorough and reliable statistics on the insurance marketplace. Like the NMC, Texas is just beginning efforts in this direction. Texas is a pioneer in gathering insurance data independently of industry-controlled statistical organizations, and we intend to have a continuing flow of Zip Coded data on automobile, homeowners and commercial insurance. We have just scratched the surface in our ability to detect redlining and other unfairly discriminatory insurance practices, and this data flow will put us in a much better position to protect the insurance-buying public in the future. To have any hope of a national picture in the foreseeable future, we must have Congressional action. Insurance is, I fear, just too powerful a special interest in most states.

Underwriting Guidelines

We are looking not only at evidence of redlining, We are reviewing companies' underwriting guidelines to determine the causes. Several common underwriting guidelines adversely affect the availability of homeowners insurance in minority and low-income neighborhoods as well as in some rural and inter-urban communities. Texas' Office of Public Insurance Counsel (OPIC) reviewed the homeowners underwriting guidelines filed with our Department by insurance companies this year and issued a report (Attachment C) showing that:

- 88 percent of the companies have age-of-home restrictions.
- More than 90 percent of the companies have minimum coverage amounts, often above Texas' median housing value of $42,500. Many won't write homes valued under $60,000 or higher!
- 60 percent of the companies have location restrictions. While not as overt as a red line map, these restrictions prohibit coverage for certain consumers in very vague terms without objective standards (e. g. "unprotected" areas).

All of these underwriting guidelines have an adverse impact on the availability of homeowners insurance for consumers in older or lower income inner-city and rural neighborhoods.

Regulatory action against unfair underwriting practices is a new phenomenon but I predict you will see much more of it as the trend toward election or appointment of consumer-oriented insurance commissioners continues throughout the nation. In Texas, the Commissioner received clearcut legislative authority only last year to request and receive companies' underwriting guidelines and to use them in enforcement actions (but we are not free to disclose them to the public, which inhibits our ability to make competition in price fully effective—we need an informed consumer for that). Our Department just initiated disciplinary actions against 59 companies, including some of the largest auto writers, for alleged unfairly discriminatory underwriting guidelines, which either exclude people or force them into high-rate companies merely because they are single, have only one car, have a driver's license from the "wrong" country, won't buy another kind of insurance policy from the same company or had been rejected or canceled by a different company.

On May 2, 1994, I imposed a Texas record fine of $850,000 on Allstate for applying similar guidelines. In this case, we actually received videotapes showing agent after agent turning down an applicant because he was single, had only one car and was not in the market for any insurance but an auto policy.

Although the practices involved in these disciplinary cases do not involve excluding specific neighborhoods, they do have disproportionate impact on racial and ethnic minority populations and low-income consumers. That is why the focus on redlining should not be limited to discrimination based on geographic location alone.

Besides the disciplinary actions mentioned above, I am considering further rule-making, enforcement actions and proposed legislation to further combat unfair underwriting practices and redlining. One of the ideas I'm considering is requiring that an underwriting guide be demonstrated as risk related by statistics in order to use it in Texas.

Reporting Issues

There are a number of specific issues related to data collection that the Committee needs to consider if it is to fully address this issue. I would like to discuss several of these issues.

- *Census Tract Versus Zip Code:* Although current reporting of neighborhood-related insurance data is by Zip Code in the vast majority of states, it is not sufficient to answer questions about redlining. Congress would come closer to getting the information it needs on redlining if obtains reports by census tract. One reason is that related demographic information from the Bureau of the Census is far more complete and accurate for census tracts than it is for Zip Codes. In addition, census tracts tend to be smaller and more demographically homogeneous than Zip Codes, thereby giving a clearer, better focused picture of the treatment of minority and low-

income neighborhoods than we get from looking at Zip Code data. Furthermore, Zip Codes exist to expedite mail handling and are subject to change whenever necessary to further that objective. Census tract boundaries are less likely to shift.

I believe the larger insurance companies that would object to reporting could easily adapt to census-tract reporting because the necessary software is readily available. Some have suggested requiring the government to provide insurance companies with this software. If insurers claim that census tract is too difficult, you might consider requiring reporting by 9-digit Zip Code, which can, as I understand it, be used to construct census tracts. All insurers must have this information in order to obtain mail cost savings.

• *Race and Gender Data:* I support the collection of race and gender data because it will further the objective of discouraging unfair discrimination, including those forms of discrimination that have the intent and/or effect of redlining. This kind of data collection is essential if Congress is to determine whether insurance companies are, in fact, discriminating based on race or gender. It will also provide stronger factual support for legislative, judicial and regulatory actions to protect the rights of racial and ethnic minority populations to buy insurance at fair and affordable rates. Finally, and possibly of greatest importance, such data might increase the availability of insurance to minorities by opening the eyes of many insurance companies to the effect of their underwriting guidelines on these populations. Such companies could be expected to act to increase their minority business to avoid discrimination suits, regulatory action and further legislation.

At my March 31 redlining hearing in Houston, an ITT Hartford representative testified the company had gone through a painful process in which it came to realize its underwriting practices were causing unintended problems for some minorities. The company is taking initial steps to turn this around, including a program to develop more minority agents to work in underserved areas. Thus, simply by forcing companies to examine the effects of their underwriting guidelines on minorities and low-income consumers, we can begin the process of their own self-examination and reform.

• *Claims Information:* Claims information is vital if Congress, regulators and others are to accurately assess the extent of redlining and other forms of unfair discrimination in the sale and pricing of insurance and take appropriate corrective action. What if you collect data from an insurer and see what appears to be unfair discrimination based on where it wrote its policies? What if it then says it is making a sound business judgment based on the claims? Where are we then?

Claims data are highly relevant information, and we seek claims data in our own data calls because assuring fair rates is only half the regulatory battle. If a homeowner in a predominantly minority area pays the same rate as one in an upscale corner of the same city but receives scaled-down benefits if he or she has a fee or other loss, that is redlining as surely as rejection for coverage or assignment to a high-risk company. This, in fact, might very well be happening in some of our cities. Public adjusters have told our Department that some insurance companies have different payment standards in minority areas than in other areas. Trial lawyers and some adjusters also have alleged that insurers pay smaller damages for minority claimants. But, as an insurance regulator, I need solid statistical support for rulemaking and enforcement actions against such behavior, and I believe Congress also needs more than hunches and anecdotal evidence. You need these data!

Finally, enlightened insurance regulators and companies are coming to understand that they have an obligation to attack the root cause of rising insurance rates by encouraging better construction, stronger defenses against crime and other loss-prevention measures. The Texas Department of Insurance recently created its first Safety Unit to lead the way in this effort. Claims data, by neighborhood, can help regulators and the industry target areas where loss prevention efforts can do the most good.

• *Additional Data Needs:* Data on personal auto insurance should be collected. Auto insurance is as important, if not more important, than homeowners insurance in minority and low-income neighborhoods where homeownership is more of a dream than a reality. Texas' data show significant redlining in auto insurance.

Renters insurance should be included in the definition of residential property insurance as a designated lines of insurance for data collection. Because many low income and minority consumers are unable to purchase homes but need insurance for their personal property, data is needed on renters insurance.

Also, data on the age of the insured should be collected for homeowners and auto in addition to region, race, gender, age of home and location of home.

• *Availability of Data to Public:* Data should be made available to the public as soon as possible. I suggest that the federal agency receiving the data be allowed time for review, but a preliminary report should be issued 30 days after the data

is due from insurers and a final report issued 60 days after the data is due from insurers. Losses by individual insurers by Zip or census tract a should not be held in closed records. To combat unfair discrimination in claims payments, it is crucial that this information be open to the public.

• *Automatic Sunset Provision:* Data collection should not automatically sunset. Its purpose will continue to exist in the future. Congress would be remiss to pretend that redlining is a disease that can be cured in a short period of time with no danger of remission.

Conclusion

Based on available data, it is obvious that redlining is a problem in many urban communities and rural areas. Other forms of discrimination, such as underwriting guidelines that deny coverage or assign consumers to high-risk, high-rate companies because they are single or own only one car or don't buy other kinds of insurance from a company often have the same effect on minority and low-income people as geographic redlining. More data is necessary if policymakers and insurance regulators are to fully understand the scope of this problem and take the actions necessary to protect the insurance-buying public. Congress is to be commended for taking on this difficult but extremely important issue.

[Attachments A, B, and C may be found in the committee files.]

Senator BRYAN. Thank you very much, Mr. Hunter, for your yeoman testimony in each of these three hearings. We appreciate it. Ms. Griffin, it is nice to have you back again so soon.

STATEMENT OF MARY GRIFFIN, INSURANCE COUNSEL, CONSUMERS UNION

Ms. GRIFFIN. Thank you, Mr. Chairman, and thank you for holding this hearing to address an issue that is so critical to inner city and rural communities, the lack of availability of affordable, quality insurance.

My organization, Consumers Union, which has closely followed the insurance industry for years, is delighted to see Congress tackling the issue of redlining, a problem that has plagued communities for decades.

Insurance, as we all know, is an indispensable part of modern American society. You cannot buy a home, drive a car, or open a business unless you have insurance. Given the critical and indispensable role of insurance, insurance should be both available and affordable to all, regardless of race, ethnicity, gender, or location. But we are a long way from achieving that goal.

Studies, tests conducted by fair housing groups, and ongoing litigation, reveal more than isolated instances of illegal insurance discrimination and disparities in the cost and availability of insurance throughout the country.

Most recently, the National Fair Housing Alliance released the results of their testing, which revealed widespread discrimination. Using testers with homes of similar value, size, and age, but located in different neighborhoods, middle class African American, Latino, and white, the group found that insurance companies applied their standards differently in black and Latino neighborhoods than they did in white neighborhoods. For example, a tester calling from a minority neighborhood was told the company could not insure for less than $55,000, but in a white neighborhood, a similar house valued at less than $55,000 was provided a quote.

And in our own city, the District of Columbia, where I am a resident, in a survey of yellow pages we conducted we found that State

Farm, which enjoys approximately 20 to 25 percent of the auto insurance market in the District and 17 percent of the homeowners' market, has 18 agency locations in the city, 10 of which are in the northwest area of the city, most on Connecticut and Wisconsin Avenues. Apparently State Farm is a better neighbor in suburban Maryland, where one can find over 120 agent locations. And Allstate has only 1 office in the District, but extends its hands generously out into the suburbs, to where it has 180 offices in this area.

The effects of redlining exact a heavy toll on our economy, destroying jobs and economic development and devouring much-needed tax revenues. Such practices must be stopped. The question is, How?

We believe our lawmakers have a fundamental responsibility to ensure communities access to affordable and quality insurance. For decades, the insurance industry has kept Government at bay through intense lobbying activities at both the Federal and State levels. Another impediment to achieving a fair and functional insurance market is the patchwork of 50 State laws and regulatory schemes.

Relying on only this system inhibits the free flow of ideas and information that is necessary to develop and implement a public-spirited regulatory approach toward the private sector. It is time for Congress to act.

While there are many possible solutions to the redlining problem, from developing and enforcing existing antidiscrimination laws, to changing rate structures, to market incentives, to voluntary efforts by the industry, the first step toward resolving this problem is through exposing the industry to a little sunshine. We view the collection and dissemination of data as part of the solution, an integral part.

What kinds of data would be useful to determining the extent and scope of the problem? Well, as Mr. Hunter said, we need to know about the number of policies sold and the cost and type of coverage, as well as the race, ethnicity, and gender of the policyholders, to determine the price and quality of insurance sold and help identify those areas or residents most underserved.

The data must be released in census tract format to facilitate demographically based comparisons and a better understanding of underwriting patterns.

Of course, extremely critical to the analysis of the market and figuring out the reasons for the disparities is loss data. Insurers often argue that they cannot write policies in certain minority and low-income neighborhoods because they suffer from high losses. If companies do not report their losses, we will never know if the high premiums charged in these neighborhoods are based on higher risks, or whether these high premiums are used to subsidize other neighborhoods, as some studies suggest.

We also need to assess companies' underwriting criteria, because many have criteria unrelated to risk, are based on subjective assumptions, and have a disparate effect on certain neighborhoods or residents. Not only will this information tell us whether the criteria insurers use are themselves discriminatory, but also whether, in light of the statistics, they are being applied fairly.

While discriminatory behavior must be addressed at its core, by changing the culture and environment that allows such behavior to fester, experience with civil rights legislation has taught us that Government action in the form of legislation is sometimes a necessary catalyst to that change.

We hope Congress takes action to provide the information necessary to assess how well the industry is serving the economic and social needs of our society, and whether regulatory or legal changes are necessary for our economic growth and well-being, and again, we thank you for holding this hearing.

[The prepared statement of Ms. Griffin follows:]

PREPARED STATEMENT OF MARY GRIFFIN

Consumers Union appreciates this opportunity to testify on an issue that is critical to inner city and rural communities—the lack of availability of affordable, quality insurance. My organization, which has closely followed the insurance industry for years, is delighted to see Congress tackling the issue of redlining—a problem that has plagued communities for decades. We thank you, Mr. Chairman, for holding this hearing to shed light on this problem.

Insurance, as we all know, is an indispensable part of modern American society. Examples of the relevance of insurance to our everyday lives include:

- After food and shelter, insurance is the single largest annual consumer investment.
- The American dream of homeownership remains unrealized if people cannot purchase insurance to protect the property against fires, theft and other losses.
- In most parts of the U.S., a car is a necessity for transportation to and from work. It makes automobile insurance a necessity, too, since most states require drivers to carry liability and uninsured motorist coverage.
- To bring businesses into a community, insurance must be available, not only to protect the business' property but also to cover liability for risks associated with the business. And if it is a contracting or development business, insurance for bonding purposes is critical to its operation.

Given the critical and indispensable role of insurance, insurance should be both available and affordable to all, regardless of race, ethnicity, gender, or location. But we are a long way toward achieving that goal.

THE PROBLEM OF REDLINING

Redlining—when insurance is not sold or marketed in certain neighborhoods or only policies which provide inferior coverage or at high premiums are sold in those neighborhoods—is well-documented and decades old. Studies, tests conducted by fair housing groups, and ongoing litigation reveal more than isolated instances of illegal insurance discrimination and disparities in the cost and availability of insurance among neighborhoods of different racial and income characteristics.

The following represents only a partial list of some of the evidence that reveals communities are discriminated against in the sale or pricing of insurance.

Studies

- The Missouri Department of Insurance, in a study of homeowners insurance released in 1993, found that 1) residents in predominantly minority low-income urban areas pay more for their insurance than other residents of Missouri, including low-income whites and 2) companies pay out less for claims in low-income minority areas than in low-income white neighborhoods, suggesting that companies discriminate on the basis of race, not on the basis of loss experience.
- In a report issued in April on underwriting guidelines used by companies in Texas, the Texas Office of Public Insurance Counsel found that companies representing approximately 90 percent of the homeowners market have minimum value or maximum age restrictions that prevent homeowners with lower-value homes or older homes from purchasing insurance. Among some of the other restrictions companies apply are those based on "lifestyle" which restrict coverage based on living conditions, living arrangements and perceived morals of the applicant.
- A study released by ACORN last February showed 1) that minority homeowners in many markets are significantly less likely than whites to carry homeowners insurance, 2) that, when consumers shop by telephone, agents are more likely to quote a price on a homeowners policy in a white neighborhood than in a minor-

ity one and 3) that the price is likely to be more favorable in connection with the home in the white neighborhood.

• Studies of the automobile insurance market in both Texas and New York revealed that the likelihood of consumers being placed in the assigned risk plan (program for high-risk drivers) had more to do with where one lived or with one's economic status than with one's driving record—the poorer the area or the greater the minority population, the higher the number of people in the plan.

• In a survey of insurance coverage of those who suffered damage in the disturbances in Los Angeles in 1992, the California Department of Insurance found that 52 percent of those who called in to report damages and were later contacted by the department had no insurance and 42 percent of those who had insurance reported they were underinsured.

Testing

Earlier this month, the National Fair Housing Alliance released the results of its testing in four cities—Atlanta, Chicago, Louisville and Toledo. The testing revealed widespread discrimination and disparate treatment of testers calling from middle class African-American and Latino neighborhoods as compared to other testers calling from white neighborhoods with homes of similar value, size and age. Some of the discriminatory practices used by companies/agents include:

• Refusing to provide insurance because of the age of the home, but only applying this standard to homes located in minority neighborhoods.

• Refusing to insure properties in minority neighborhoods because of the market value of the homes.

• Offering only market value policies rather than replacement cost coverage (insuring the cost of replacing the home or contents rather than insuring only for market value) policies in homes in minority neighborhoods.

• Requiring inspection of a home prior to providing information on the cost or type of insurance available in minority neighborhoods.

• Requiring a credit check for applicants in minority neighborhoods.

Litigation

• In Milwaukee, Wisconsin, the National Association for the Advancement of Colored People (NAACP) brought an action against American Families Insurance Company, alleging that agents were instructed not to sell in minority neighborhoods.

• In Pittsburgh, Pennsylvania, a suit was brought against an insurance company by a group of agents who were told not to sell insurance policies in African-American neighborhoods.

• In Toledo, Ohio, the Toledo Fair Housing Center filed a complaint against Nationwide alleging discrimination under the state fair housing laws.

And, in our own city of the District of Columbia, we conducted a survey last year based on a review of the yellow pages which provides a picture of the marketing practices in the area. State Farm, which enjoys approximately 20 to 25 percent of the auto insurance market in the District and 17 percent of the homeowners market, has 18 agency locations in the city, 10 of which are in the northwest area of the city, most on Connecticut and Wisconsin Avenues. Apparently, State Farm is a better neighbor in suburban Maryland where one can find over 120 agent locations. And Allstate has only 1 office in the District but extends its hands generously out into the suburbs where it has 180 offices.

Also in our nation's capital, a group of former and current employees accused one of the area's largest insurers, GEICO, of deliberately refusing to cover qualified minority applicants. Among the allegations was the company practice of not requiring inspections of homes in the affluent, primarily white zip codes of the northwest part of the city but requiring them in other primarily minority zip codes. The Superintendent of Insurance recently instituted a market-conduct investigation to examine GEICO'S business practices.

Insurance departments, civil rights, consumer, and community groups, agents and employees of the companies all have come forward with allegations or studies indicating that companies illegally discriminate against minorities and insurance for residents of minority and low-income neighborhoods is often not available or is more expensive than in white neighborhoods..

There is clearly a problem in the availability and affordability of insurance products in low-income and minority communities and company underwriting practices. The effects of such redlining exact a heavy toll on our economy, destroying jobs and economic development and devouring much needed tax revenues. Society at large only loses from these destructive and discriminatory practices. They must be ended. The question is—how?

THE NEED FOR CONGRESS TO ADDRESS THE PROBLEM

We believe our lawmakers have a fundamental responsibility to ensure communities access to affordable and worthwhile insurance. For decades the insurance industry has kept the reformist impulses of government at bay through intense lobbying activities at both the federal and state levels. Since 1945, insurers have been shielded from antitrust laws and the FTC Improvements Act of 1980 basically prohibits the Federal Trade Commission from even studying the business of insurance.

These restrictions and others keep us far from the goal of making insurance available and affordable to all. Another impediment to achieving a fair and functional insurance market is the patchwork of 50 state laws and regulatory schemes under which the business of insurance is primarily regulated. This system inhibits the free flow of ideas and information that is necessary to develop and implement a public spirited regulatory approach toward the private sector.

It is time for Congress to act. While there are many possible solutions to the redlining problem, from development of and active enforcement of discrimination laws to changing rate structures to instituting or strengthening current public insurance programs to market incentives, the first step toward resolving the redlining problem is through exposing the insurance industry to a little sunshine. We have been kept in the dark for too long, enabling insurance companies to control the debate over issues of access and affordability to quality insurance and the way in which the market is structured.

We view the collection and dissemination of data as part of the solution, an integral part. The federal government needs to enact legislation to provide for a nationwide data base of information on insurance. Only with this information can we begin to assess the extent and scope of the problem and engage in discussion about what may need to be done. The following data are examples of the kinds of information needed to assess the problem:

- *Annual disclosure of the policies sold in each census tract (zip+4 reporting) by type of policy on a company-by-company basis:* Information about the number of policies sold and the cost and type of coverage as well as the race, ethnicity and gender of the policyholders will provide essential data to determine the price and quality of insurance sold and help identify the areas or residents most underserved. Data should be collected on automobile, homeowners and insurance sold to small business owners. The data must be on a census tract basis (companies to report on a zip+4 basis) to facilitate demographically-based comparisons and reveal underwriting patterns.
- *Disclosure of loss data to determine whether higher prices charged in some neighborhoods are justified by higher losses (claims):* Insurers often argue that they cannot write policies in certain minority and low-income neighborhoods because they suffer high losses. If companies don't report their losses, we'll never know if the high premiums charged in these neighborhoods are based on higher risks or whether these high premiums are used to subsidize other neighborhoods, as some studies suggest.
- *Disclosure of underwriting criteria.* Studies indicate that underwriting criteria unrelated to risk and based on subjective, biased assumptions are used to determine who should be sold insurance. Not oniy will this information tell us whether the criteria insurers use to determine whether to accept an applicant for coverage are themselves discriminatory but also whether, in light of the statistics, they are being applied fairly.
- *Information about where agents are located to determine which neighborhoods are underserved.* Without access to insurance agents, many find it difficult to purchase insurance and of the quality they desire at the price they can afford.

While discriminatory behavior must be addressed at its core, by changing the culture and environment that allows such behavior to fester, experience with civil rights legislation has taught us that government action in the form of legislation is sometimes a necessary catalyst to that change. We cannot wait for the industry to act on its own initiative, an industry that has for too long been mired in resistance to change.

We hope Congress takes action to provide the information necessary to assess how well the industry is serving the economic and social needs of our society and whether regulatory or legal changes are necessary for our economic growth and well-being.

Senator BRYAN. Thank you very much, Ms. Griffin. We are pleased to have you again.

Ms. Schubert, let me welcome you to our subcommittee hearing and invite your testimony now.

STATEMENT OF LYNN M. SCHUBERT, ASSISTANT GENERAL COUNSEL, AMERICAN INSURANCE ASSOCIATION

Ms. SCHUBERT. Thank you, Chairman Bryan, and thank you for inviting us here today to talk on this important topic of access to insurance for urban residents and businesses.

AIA represents more than 270 companies writing property and casualty insurance in every State and jurisdiction of the United States. These members are concerned about this critical issue.

Additionally, I have been authorized today to present this testimony on behalf of the Independent Insurance Agents of America and the Council of Insurance Agents and Brokers. I would request that our written statement be entered into the record, and I will try and summarize that today.

Senator BRYAN. It will be made a part of the record.

Ms. SCHUBERT. Thank you.

We have one overriding goal on this issue, and that is that urban residents and businesses, as all other Americans, must be able to purchase attractive insurance products at a price reasonably based on the risk. AIA, IIAA, and the council members are committed to working with legislators, regulators, consumers, and brokers to ensure that this occurs.

To determine whether or not insurance is available in all areas, we would support Federal data collection of insurance information if that data collection is designed to produce a fair, efficient, and effective study of insurance availability and cost. H.R. 1188, pending in the House, we believe is such a measure, and we do support that bill.

Any data collection will show that there are some areas, especially in our cities, which have higher numbers of residents and small businesses without insurance than other areas. These discrepancies are related to a whole host of socioeconomic circumstances faced by people who work and live in urban areas, and which also increase the cost of insurance.

Outright racial or ethnic discrimination also may occur. We hope that it is infrequent. We know that it is a violation of both Federal and State law. We advocate stringent prosecution wherever it is found. These discrepancies, whether they are caused by economics or by discrimination, must be addressed.

It is cold comfort to the citizens for whom insurance is unavailable to explain to them the reasons why the problem exists. We believe it is time to start attacking these problems head-on, and the meetings that we have been having with State regulators, including the one we have had recently with Commissioner Hunter that he referenced, is an effort by the industry to do just that.

It is impossible to say that there is not one underwriter or one agent or one insurer out there who is illegally discriminating in the selling of insurance. However, we do not believe that it is a systemic problem, but rather, if it occurs, it occurs in isolated instances.

The most important thing to note in this discussion is that discrimination is illegal. All States have laws against unfair discrimination in the insurance industry. The National Association of Insurance Commissioners Model Unfair Trade Practices Act prohibits arbitrary underwriting decisions based on geographic location alone

as unfair discrimination. AIA strongly endorses this provision, and we have supported its adoption by the NAIC and by the State legislatures.

If insurers are illegally discriminating, they should be prosecuted. States currently have the authority to do so, and are doing so in appropriate situations. There is, however, a bottom-line question that should be addressed—whether those urban consumers wishing to purchase insurance currently are able to do so. Based on the studies which have been done, it is our belief that the answer is yes.

Those studies are discussed in detail in our written statement. However, there are other studies which reach different conclusions. While we have a detailed analysis of the cause of these differences, we are not here to argue the numbers today. Rather, those differences are the very reason we are willing to support Federal data collection of information on the availability and cost of insurance.

We welcome thoughtful investigation and analysis of this issue. The parameters of such a data collection effort, however, are critical. Inordinate cost of collecting data with limited value would not assist the insurance consumer, but rather harm that consumer with either higher prices or possibly less financially sound insurers.

Any Federal data collection should be drafted in a fashion to provide quick, efficient, and cost-effective data. Collection of data which reveals what insurance is being sold, where it is being sold, who is selling it, and how much it costs the consumer would answer the question of whether or not insurance is available. That is the question that Representative Kennedy posed. Is the insurance available?

This collection should be undertaken in a format to provide the most information in the most useful form in the most cost-efficient fashion. We believe that is 5-digit ZIP code. This information would allow regulators to focus efforts on ZIP codes with significant disparities between numbers of homeowners and numbers of homeowners' policies, rather than be required to review detailed information for huge numbers of census tracts where no problems exist whatsoever. That is simple disclosure.

Insurers are not trying to hide information, as has been alleged here. We currently report reams of data in 50 States. There is plenty of sunshine on the insurance industry, and we are willing to do the same thing at the Federal level.

Senator Feingold mentioned the Missouri data, which is collected by ZIP code, and Commissioner Hunter mentioned the Texas data which is collected by ZIP code. That information has allowed them to make conclusions about availability of insurance based on the five-digit ZIP code, and we believe that information would be effective at the Federal level.

If I could just summarize, we are working on a number of proactive programs with the Urban League, the Big I, the insurance departments of many States, and State legislatures to address the issue of insurance availability by increasing the number of minority agents, increasing the number of agents in urban areas, and, conducting tours for insurance underwriters of neighborhoods where perhaps insurance might not be as readily available as in other neighborhoods.

We believe these partnerships are the way to move forward in trying to really deal with the problems of urban America, and not additional data collection at a census tract level that would cost both the insurance industry and insurance consumers more money.

Thank you very much.

[The prepared statement of Ms. Schubert follows:]

PREPARED STATEMENT OF LYNN M. SCHUBERT

The American Insurance Association is a national trade organization representing more than 270 companies writing property and casualty insurance in every state and jurisdiction of the United States. AIA members write 36 percent of all commercial property and casualty insurance in the United States. They also write a significant amount of personal, homeowners and automobile insurance. AIA member companies employ more than 145,000 people and pay $2.2 billion in state taxes and fees (including payroll taxes) to state governments each year.

We appreciate the opportunity to be here today to discuss the important topic of access to insurance for urban residents and businesses. I have been authorized to present this testimony not only on behalf of the AIA, but also on behalf of the Independent Insurance Agents of America (IIAA) and the Council of Insurance Agents and Brokers (The Council). IIAA is a trade association representing nearly 300,000 independent insurance agents. The Council (formerly the National Association of Casualty and Surety Agents, NACSA,) represents the nation's 300 largest commercial insurance agencies and brokerages who write over $70 billion in premiums annually.

These organizations have one over-riding goal on the issue of insurance access and availability Chairman Bryan: urban residents and businesses, as all other Americans, must be able to purchase attractive insurance products at a price reasonably based on the risk. AIA, IIAA and The Council members are committed to working with legislators, regulators, consumers and brokers to ensure that this occurs.

It is a fact that certain areas—especially in our cities—have higher numbers of residents and small businesses without insurance than other areas. These discrepancies are related to a whole host of socio-economic circumstances faced by people who work and live in the urban areas, and which also increase the cost of insurance. Outright racial or ethnic discrimination may also occur. We hope that it is infrequent. We know that it is a violation of federal and state law. We advocate stringent prosecution wherever it is found.

To determine whether or not insurance is available in all areas, we could support federal data collection of insurance information - if it is designed to produce a fair, efficient and effective study of insurance availability and cost. H.R. 1188, pending in the House, is such a measure, and AIA, IIAA and The Council support this bill. The details of the bill and the reasons for our support are addressed later in this testimony.

If there are availability problems, however, whether they are caused by economics or by discrimination, they must be addressed. It is cold comfort to the citizens for whom insurance is unavailable to explain to them the reasons why the problem exists. We believe it is time to start attacking these problems head-on.

We encourage and will participate in thorough and thoughtful dialogue on the subject of urban insurance coverage with the goal of developing workable solutions to the problems. Specifically, we would like to work with legislators and regulators to develop products and marketing ideas which adequately serve urban residents and businesses. We want to discuss the establishment of market assistance plans and other programs to facilitate greater access to insurers. For example, we already are working with regulators in a number of states on programs to bring urban-based independent agents together with companies.

One state which is moving forward on this issue is Georgia. In Atlanta, AIA, in conjunction with the Urban League, the Independent Insurance Agents of America, the Insurance Department and state regulators, has established a task force to address the issue of insurance in urban markets. One of the first projects of the task force is the Agent/Insurer Partnership. The task force has put together a directory of profile forms completed by minority agents and has distributed it to standard insurance companies. These companies have reviewed the profiles, and are in the process of making agency appointments from the directory. While the process is not complete, a number of appointments already have been made. Now that this program has proven successful, we are working to expand these efforts nationwide.

In addition, we also support the inclusion of homeowners insurance in existing Fair Access to Insurance Requirement Plans (FAIR) to address the needs of homeowners who are unable to find insurance in the voluntary market.

In California we publicly have supported a proposal which would provide for statewide rating of basic first party insurance in the context of a cost effective no-fault system. We believe this system should be considered in other states where auto insurance costs are too high, especially for low-income urban citizens. We will continue to explore other options along these lines for other lines of insurance.

Allegations have been made that insurance is unavailable in urban areas due to insurance redlining. Further, this Committee has asked us to address the question of whether insurers illegally discriminate in providing property insurance. Before any further discussion of the positive efforts of the industry in the areas of insurance availability and cost let me address the specific question posed by the Committee. To answer this question we need to start with a discussion of the concept of redlining.

DEFINITION OF REDLINING

Redlining is an illegal offensive practice that cannot be tolerated. AIA opposes redlining. The term has long referred to an attempt to discriminate on the basis of race or ethnic origin by not doing business within certain "redlined" neighborhoods. The practice is illegal, reprehensible, inexcusable and must not be tolerated. Violators should be punished.

Defining the term, however, in order to identify the specific activities that constitute the practice of redlining, has proven a difficult task. Redlining is an emotionally charged term that connotes different things to different people and, as such, has defied definition in a universally accepted manner. In recent years insurance regulators and industry representatives have spent many hours debating the issue and hammering out language describing and prohibiting certain practices that constitute redlining. This language, embodied in the National Association of Insurance Commissioners (NAIC) Model Unfair Trade Practices Act, defines and prohibits the following as unfair discrimination:

> Making or permitting any unfair discrimination between individuals or risks of the same class and of essentially the same hazard by refusing to insure, refusing to renew, canceling or limiting the amount of insurance coverage on a property or casualty risk solely because of the geographic location of the risk, unless such action is the result of the application of sound underwriting and actuarial principles related to actual or reasonably anticipated loss experience.

We strongly endorse this provision. We have supported its adoption by the NAIC and its passage in state legislatures across the country. The language clearly proscribes arbitrary underwriting decisions based upon geographic location alone. It recognizes, however, that sound underwriting and actuarial principles cannot be ignored by the industry—insurers must make rational underwriting decisions that will preserve their solvency and protect consumers.

AIA has a clear record of opposition to the arbitrary reliance by insurers upon physical location alone when rendering underwriting decisions. Throughout our history we have consistently stated our belief that insurance should be readily available, subject to fair and sound underwriting principles. The first step to making insurance available is the development of products that are attractive and affordable for urban residents and businesses.

THE FIRST STEP TOWARD A SOLUTION

We must focus our attention immediately on a fundamental issue, i.e., the rapid development and approval of attractive and affordable insurance products tailored to meet the needs of urban consumers.

In California, we have joined forces with a broad coalition of consumer and civil rights groups led by Consumers Union and the Latino Issues Forum to create an innovative, no-frills no-fault automobile insurance policy. This policy is a perfect example of a creative, practical and sound solution to a real problem of people in need.

The policy is designed to be offered statewide at one low price. It guarantees all injured accident victims at least $15,000 in medical and wage loss benefits for a uniform statewide price, and removes nuisance and minor injury litigation for non-economic losses. Independent actuaries have concluded that the basic coverage could be sold, on an actuarially sound statewide basis, for $220, saving California consumers $1.8 billion in the first year alone.

Unfortunately, this product is not yet available to California consumers. During recent sessions of the California legislature, the bill that would pave the way for provision of this product in the marketplace has been bottled up.

The National Conference of Insurance Legislators recently has approved a model automobile insurance law providing $15,000 of basic personal compensation coverage and property damage liability coverage, along with limits on lawsuits and health care costs. AIA estimates the standard price for the minimum mandated coverage would be $117 in Vermont, $146 in Missouri and $199 in Texas.

We are working to inform legislators and regulators about the potential benefits of this and similar new products. AIA encourages all state legislators and insurance regulators to maintain a receptive attitude toward innovative and experimental insurance products. These kinds of products will serve as the key that will guarantee an open door to insurance for all consumers.

IS INSURANCE AVAILABLE

The bottom line question that must be addressed is whether those urban consumers wishing to purchase insurance currently are able to do so.

A number of studies from 1979 through 1993 show that a large percentage of homeowners have homeowners insurance. In 1979, the AIA sponsored a nationwide study on availability of homeowners insurance. That study showed that 98 percent of homeowners had homeowners insurance. Eighty-eight percent of those surveyed had comprehensive coverage covering fire, theft, vandalism and liability. Fifteen percent had more limited coverage.

In 1980, R.L. Associates, a private research firm in Princeton, N.J., conducted a similar survey for the All-Industry-Research Advisory Council (now Insurance Research Council). This survey focused on the urban core of America, surveying urban core neighborhoods in six of the largest American cities: Atlanta, Chicago, Cleveland, Los Angeles, Philadelphia, and New York (borough of Brooklyn). The results of the 1980 survey were consistent with those of 1979. In fact, the total percentage of homeowners with homeowners insurance increased from 98 percent to 99 percent. The percentage with comprehensive versus more limited coverages also increased, from 88 percent to 90 percent.

In 1993, a similar study was commissioned by AIA and performed by R.L. Associates. The survey covered the experiences of homeowners with regard to obtaining various forms of property insurance and their attitude toward that coverage. The results of this study conclusively demonstrate that property insurance Is widely available in each of the cities surveyed, and that such coverage is "very easy" or "somewhat easy" to obtain for the vast majority of policyholders. During the past five years few respondents have been turned down for any type of homeowners coverage, and an even smaller percentage have had their coverage canceled or non-renewed for any reason.

When combined with previous empirical research, this survey indicates that the percentage of urban homeowners with property insurance is comparable to that in suburban and rural jurisdictions. Moreover, to the extent that some homeowners are without coverage, this decision is likely to be based on personal choice or economic constraints, rather than difficulty in obtaining insurance.

Following are key highlights from the survey of 1,502 urban homeowners in Chicago, Los Angeles, Atlanta, Brooklyn, Cleveland and Philadelphia:

- Less than 2 percent of the homeowners surveyed in the six cities did not carry any homeowners insurance. Ninety-three percent had comprehensive coverage covering fire, theft, storm damage, vandalism, and liability. About 5 percent carried more basis home insurance policies covering fire damage only or fire and windstorm damage.
- The percentage of homeowners without any coverage ranged from less than 1 percent in Chicago and Atlanta to 3 percent in Los Angeles.
- There were no significant differences among African-Americans and whites in terms of insurance coverage. Ninety-nine percent of African-American homeowners carried either comprehensive (92 percent) homeowners coverage or more basic policies (7 percent). Ninety-eight percent of those identifying themselves as white had some homeowners coverage, including 94 percent with comprehensive policies and 4 percent with basic coverage.
- Nearly nine in ten (87 percent) urban homeowners said it was very or somewhat easy to find homeowners insurance. An even higher share (93 percent) said it was convenient to contact an insurance agent or insurance company.
- Urban homeowners use a variety of methods to shop for and purchase homeowners insurance including telephoning an agent, having an agent come to their homes, traveling to an agent's office, purchasing through a mortgage or real estate office, and purchasing home insurance by mail. A significant number of homeowners in each of the six cities have used one of these methods to purchase home insurance.

• Only 3 percent of urban homeowners had experienced cancellation or non-renewal of home insurance coverage during the past five years. Reasons for cancellation or non-renewal cited by this small group of homeowners included non-payment or late payment of premiums, loss experience (multiple theft or fire claims), insurance companies that ceased writing home insurance, and physical problems with the property.

• Very few respondents (3 percent) said that they were aware of anyone in their neighborhood who had experienced difficulty in obtaining homeowners insurance.

Other surveys and studies show similar results. The Roper Organization Inc., a nationally known public opinion survey firm, included a question on homeowners insurance as part of a representative sample of 1,976 Americans for the 1992 Public Attitude Monitor published by the Insurance Research Council. Conducted during June 1992, the survey found that 94 percent of those surveyed owning homes had homeowners insurance. Not surprisingly, the Roper survey showed some variations in the share of homeowners with insurance by region, income and community type. For example, the survey indicated that homeowners living in central cities of metropolitan areas with populations of greater than 250,000 actually were more likely to have homeowners insurance (96 percent) than the population as a whole. Central city residents owning homes, including those living in very large cities with more than a million people, were more likely to have homeowners insurance than persons living in suburbs (95 percent) and those living in rural areas and small towns (91 percent).

The 1992 Roper findings are nearly identical to those from another independent national survey conducted by Cambridge Reports Inc. in 1989 on home ownership and home insurance rates. The Cambridge survey found that 95 percent of homeowners nationally carried homeowners insurance.

Other surveys also document that small business insurance consumers are largely able to obtain desired insurance coverages and that voluntary market availability improved steadily during the 1980s. The purchase of various insurance coverages by small businesses increased during the 1980s. Urban small businesses were in some cases more likely to have some coverages than their suburban, small town or rural counterparts. Nationally representative surveys of small businesses (Small Business Attitude Monitor 1991, Business Attitude Monitor, 1988) conducted by the Insurance Research Council showed that the share of small businesses purchasing key coverages such as property and liability rose from 1988 to very high levels by 1991. This evidence of general availability and affordability tracks well with the independent data on the use of FAIR plans in commercial lines.

This evidence of general availability and affordability tracks well with the independent data on the use of FAIR plans in commercial lines.

Participation of the FAIR plan in the marketplace is decreasing. Commercial lines premium volume written through the FAIR Plans declined steadily in most states from 1986 through 1991 as a percentage of total commercial premium volume. For example, commercial written premiums in the Illinois FAIR Plan declined from about one quarter of one percent (0.24 percent) to less than one-tenth of one percent (.088 percent) of total commercial premium in the voluntary market. In addition to Illinois, AIA analyzed the District of Columbia and eight large urban states: California, Georgia, Massachusetts, Michigan, New Jersey, New York, Ohio, and Pennsylvania, and found that each experienced significant drops in FAIR Plan commercial lines premium volume in relation to the state commercial voluntary market. The decline in FAIR Plan premium volume in relation to the commercial voluntary market generally indicates that businesses were having an easier time finding insurance through the voluntary market.

Personal lines FAIR Plan premium volume also decreased in Illinois and other states relative to the voluntary market from 1986 through 1991. For example, FAIR Plan premium volume in Illinois dropped from just over one-half of one percent (0.52 percent) to about one-third of one percent (.036 percent) of total personal lines (homeowners) premiums from 1986 to 1991. In New York, FAIR Plan premium dropped from nine tenths of one percent of the voluntary market to under six tenths of one percent. Overall, in eight out of the nine states that we analyzed, premium volume in the FAIR plan declined in relationship to the voluntary market between 1986 and 1991, and in the remaining state where FAIR plan market penetration did not decline, the increase was less than two tenths of one percent.

The number of applications received by the FAIR Plans for commercial and personal lines combined also generally decreased from 1986 to 1991. Our analysis of applications and policies issued in the ten jurisdictions examined indicates that over that period, the number of applications received annually declined by an average of 25.5 percent and the number of policies and binders issued by each of the plans annually decreased by an average of 23.3 percent. These are all signs of improving

property insurance availability in the voluntary markets of these states and the District of Columbia. The bottom line conclusion is that the percentage of risks written by the FAIR Plan versus the voluntary market is decreasing steadily.

Small businesses located in major cities were just as likely as their counterparts in suburbs, non-metropolitan cities and towns, and rural areas to have liability insurance, more likely to have business interruption insurance, and somewhat less likely to have property insurance. In this context, urban applies to small businesses located within the city limits of a large city. As for specifically inner city businesses, the only representative study of which we are aware on these businesses was published in 1982 by All Industry Research Advisory Council (now the Insurance Research Council). This study, Availability and Use of Business Insurance by Small Urban Businesses, covers inner city small businesses in Chicago, Atlanta, Boston, Brooklyn, Cleveland, Detroit, Los Angeles, and Philadelphia. The survey indicated that at that time 92 percent of the inner city firms had some type of property-liability coverage and 86 percent had the property coverages of fire, wind and vandalism.

Small businesses in inner-city Los Angeles were as likely as businesses in the overall sample to have at least one or more of the property-liability coverages.

Although it appears from the data that insurance is available and affordable to the vast majority of residents and businesses in inner-city areas, we recognize that this still might leave some insurable risks without coverage for one reason or another. We must continue our efforts to make insurance available for all insurable risks.

POTENTIAL FEDERAL ACTION

The next question is what steps the Federal Government should take to identify and combat illegal property insurance discrimination, if such discrimination exits. As mentioned earlier, a fair, economical, efficient data collection scheme on the federal level to determine if insurance is equally available, based on the risk, for all Americans, is something AIA, IIAA and The Council could support. The parameters of such a data collection effort, however, are critical. Inordinate costs of collecting data with limited value would not assist the insurance consumer, but rather, harm that consumer with either higher prices or possibly less financially sound insurers.

Collection of data which reveals what insurance is being sold, where it is being sold, who is selling it and how much it costs the consumer, would answer the question of whether or not insurance is available. This collection should be undertaken in a format to provide the most information, in the most useful form, in the most cost-efficient fashion.

The most that is needed today is a data collection and study effort, designed to collect a limited amount of data from insurers on limited lines, in a limited number of cities, for a limited period of time. The data should answer the four issues addressed above, who, what, where and how much. It should require reporting in a format that readily is obtainable and is cost effective—five-digit zip code. Various studies could be undertaken for more complex issues such as commercial insurance, agent appointments and terminations, insurance applicants and the effectiveness of the data collection.

Data collection should be limited in time and scope to answer the question is insurance available equally in all neighborhoods at a cost commensurate with the risk. The question of whether or not insurers are illegally discriminating is a question of regulation for insurance regulators. Federal data collection can assist regulators in making this determination, but data collection alone cannot answer that question or enforce discrimination laws.

The lines of insurance raising concern are homeowners, dwelling fire and allied lines and private passenger automobile. Data collection should be limited to those lines. To determine the current situation, the duration of the study should be limited. Anywhere from one to five years of data collection would show the status of insurance availability. The unit of measurement also needs to be reasonable. Data on the existence and details of policies is kept by most insurers on a computer system which includes at most only the five-digit zip code of the property insured. Insurers have gone to great expense in recent years to install these systems so that they can report five-digit zip code information to state regulators.

The full address of the property insured often only is in a manually kept record, and sometimes, if the property is part of an umbrella policy, not even there. Virtually no insurer has a statistical reporting computer system which collects or could store nine-digit zip code information. The capital which would be required to convert existing computer systems to report on any basis other than five-digit zip code is extraordinary, and the value of data on any other basis is limited.

Last year Senate Banking Committee Chairman Donald Riegle requested the U.S. General Accounting Office (GAO) to investigate the necessity of federal reporting to determine availability, affordability and accessibility of property insurance. The GAO undertook an extensive investigation of this issue, starting with a review of existing literature, proposed bills. and state requirements. GAO staff discussed the issue with trade associations—including a number of meetings with AIA staff—consumer groups, statistical agents, research organizations and the NAIC, and ultimately developed their own analyses and conclusions.

The result of this study, the GAO Report to Chairman Riegle, "Property Insurance, Data Needed to Examine Availability, Affordability, and Accessibility Issues" was released on February 9, 1994. In analyzing what data should be reported, the report begins with the statement that collection of zip code data is important. While the report does state that census tract reporting could be more useful, it goes on to say that this would require restrictions due to the volume of data which would be generated. "The value of this reporting must be weighed carefully against the additional burden it places on companies to comply."

According to the report, the data that can be reported readily by companies (zip code data for policy information) would be useful to examine availability and affordability issues, "but will not be sufficient to determine conclusively whether unfair discrimination exists or why." However, the data would be a marked improvement over what is available today and "could serve to point regulators more effectively in directions for further probing."

At this time insurance is regulated by the states. It is up to state insurance regulators, among other things, to investigate insurer practices and punish those insurers who illegally discriminate. Analysis of data reported by zip code clearly would allow regulators and others to determine if there is a disparity between the number of owner-occupied homes within a zip code and the number of homeowners policies. Any large disparity then would indicate that the appropriate regulator needs to ask insurers for more detailed information within that particular zip code. This would limit the volume of information collected by the federal government to a manageable load, but would provide the information needed to investigate areas of concern.

Additionally, the number of areas to be studied under any federal data collection should be related to the question raised. The allegations giving rise to this issue at the federal level address insurance availability in urban areas. To determine the solution, data needs to be collected for those areas where there is alleged to be a problem. Twenty-five of the largest urban areas include approximately forty-three percent of the United States population. This number clearly is sufficient to address the question.

Any federal data collection should be drafted in a fashion to provide quick, efficient and cost effective data collection. H.R. 1188, introduced by Congresswoman Cardiss Collins of Illinois, is a bill which would gather the information necessary to determine if insurance is available in all neighborhoods equally, where the insurance is being provided, who is providing the insurance, what kind of insurance is provided, and what it costs, on a five-digit zip code basis. This information could be reported within a year, rather than the up to three years it could take for insurers to begin providing census tract data, and at a reasonable cost to the consumer, rather than the exorbitant cost to consumers of insurers implementing an entirely new reporting system for the federal government, while keeping in place their reporting systems for state regulators.

The information which would be provided by H.R. 1188 would allow regulators to focus efforts on zip codes with significant disparities between number of homeowners and number of homeowners policies, rather than being required to review detailed information for huge numbers of census tracts with no problems whatsoever.

Time and effort could be spent on addressing real problems of our urban cores rather than over-reporting and reviewing of unnecessary data.

AIA, IIAA and The Council urge the Commerce Committee to consider a federal data collection effort which will address the issue of insurance availability and cost in a rational, effective fashion.

AFFIRMATIVE EFFORTS BY THE INDUSTRY

AIA recognizes that there are a number of issues that may have an impact on urban consumers and their ability to obtain insurance. The term redlining often is used loosely as a catch-all, short-hand term to identify a wide variety of issues affecting the urban areas of our nation. AIA members and others are taking steps to address these issues. It is our belief that partnerships between the insurance indus-

try and consumer organizations, civil rights organizations and housing organizations are the most productive way to move ahead.

Location of Agents with Company Appointments

One of the most controversial issues is whether agents with standard company appointments can be found in urban areas. Some urban consumers contend that insurance companies selectively place agents in locations that discourage applications for policies from certain geographic areas. The majority of AIA member companies market their products through the independent agency system. These agents are truly independent entrepreneurs, usually representing more than one insurer. These agents are not company employees placed in a particular office by the insurance company. The companies they represent cannot and do not control the location of the agent's place of business.

However, AIA, IIAA and The Council are committed to the idea of increasing the number of minority and urban based agents with standard company appointments. The Atlanta Agent/Insurer Partnership discussed earlier is one example of what the industry is doing to move forward on this issue. Another example is insurers' participation in agent association programs such as INVEST, a program which assists students with financial difficulties to start a career in the insurance industry.

AIA and the IIAA also are working closely together on other efforts to increase the number of minority agents with standard company appointment in programs such as grouping of agents and special brokers programs.

A number of these types of programs are in the development stages around the country.

Other Marketing Systems

It is important to note, however, that about 60 percent of personal lines insurance is not sold through the independent agency system. It is sold by captive agents, employees, or by direct marketing such as mail and telephone. Increasing the number of independent agents serving urban areas alone will not be enough to resolve access problems. Other new marketing techniques will be required to better serve urban areas. AIA members currently are participating in discussions at the NAIC meetings on this subject, and would be delighted to assist regulators in developing such techniques within the limits of state and federal antitrust laws.

The Product

Residents in urban areas must have ready access to insurance products that are attractive to them as well as affordable. As discussed above, the first requirement is the product. Products can be offered which provide coverages and limits which are desirable, at a price that is affordable. AIA consistently has supported the authorization by law and the approval by regulators of such products. However, each policy must be underwritten carefully, looking at underlying risk factors. To make such products available to greater numbers of consumers, risk factors must be decreased. Specifically, I am referring to the high risk of fire, high crime rates and excessive increases in automobile repair costs and health costs.

Some view refusals to issue replacement cost coverage in homeowners' policies for risks that evidence a substantial disparity between replacement cost and market value as redlining. Again, we disagree. AIA acknowledges that many insurers will not provide this coverage when there is a wide disparity. between the replacement cost and the market value of a structure. In most instances, in order to qualify for replacement cost coverage, an insured must buy enough coverage to represent at least 80 percent of the cost of replacing the structure. This requirement may present a dilemma for insureds who own homes built before the 1950s. For many of these older homes the cost to replace the building with the exact type of materials used in the original construction far exceeds what the owner might spend to replace the dwelling using modern materials and simpler construction techniques. Replacement cost coverage is not well-suited for these kinds of properties, because insureds may be unwilling or unable to buy—and insurers may be unwilling to sell—insurance in an amount well beyond the price for which the dwelling could be sold. Insurers, however, have responded to the needs of property owners faced with this disparity. For example, a lower cost variable percentage replacement loss settlement endorsement has been developed.

This endorsement permits an insured to choose to insure at a lower percentage of insurance to replacement value (i.e., usually 50 percent, 60 percent, or 70 percent), rather than the 80 percent usually required for replacement cost coverage. Thus, if the policyholder decides to insure for 50 percent of the replacement cost of the property, the premium would be lower than coverage for 70 percent of the replacement cost. However, if the property is totally destroyed, the proceeds to the policyholder would be 50 percent of the replacement cost of the property.

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Additionally, the industry has developed repair cost policies that delete the replacement cost provision and provide that a damaged dwelling will be repaired or replaced with commonly used building materials instead of materials of like kind and quality. It is important to recognize that when faced with a dilemma such as this, the insurance industry has responded with products suited for a particular purpose. Without the regulatory approval of these products, the industry cannot address the problems of the consumer. These are further examples of the industry responding to consumer needs with specialized products.

It has been asserted that these types of products are inferior and do not provide the same coverage as is available to properties without this large difference between market value and replacement costs. However, the cost of insurance is based in part on the expected cost to pay a claim under the policy. The price of providing replacement cost policies for these types of properties is so high that prior to the development of alternative products, consumers asserted that property insurance was unavailable because it was unaffordable. To address this concern, insurers developed new products that would provide a measure of coverage and protection, but would not cost so much as to be unavailable. The price of insurance must reflect the risk. Companies will continue to attempt to address the needs of consumers by creating legitimate products that can be purchased for a reasonable price.

Marketing and Service

Marketing and servicing products in communities where English often is a second language presents special difficulties. AIA companies have added Spanish speaking customer service representatives to personal lines service centers and toll free hot lines, print posters and brochures in both English and Spanish, and have programs to target small and disadvantaged contractors. These efforts make marketing and servicing products in the urban areas more effective.

Education

Education is critical to the availability and accessibility of insurance. Education must be conducted both for consumers and for insurers. Currently AIA members are working with individual state regulators as well as the NAIC Insurance Availability and Affordability Task Force Subcommittee on Education to develop programs to increase the knowledge of average and low-income consumers about insurance, and to increase the knowledge of underwriters and agents about urban neighborhoods and opportunities. We believe this concerted effort will assist in increasing the availability and accessibility of insurance products which are truly priced based on the risk.

Product Pricing

Some consumers allege that insurers intentionally overprice a product to prevent sales in urban areas. In many states, pricing of insurance is determined through a regulatory approval process. Rates are not intentionally set higher for urban risks to prevent people from purchasing the insurance. Individual company rates should be and are based on loss experience and are subject to the review of the state insurance regulator. In many cases, urban insurance rates are the same as or lower than those applicable to risks in suburban areas. In other instances policies for risks in urban areas will be more expensive than similar risks in suburban areas. This rate disparity is due to the increased costs of certain policies, such as increased incidents and severity of claims in certain areas, or increased distance from a fire station.

Automobile insurance is a good example of this cause and effect. The cost of automobile insurance reflects the costs of goods and services that are paid by automobile insurance premiums, including litigation, health care, and auto repair. The frequency of bodily injury liability claims countrywide has increased 19.0 percent from 1987 through the third quarter of 1992, according to NAII/ISO Fast Track data. The increase in the loss cost for bodily injury liability during that same period was 67.1 percent. Meanwhile, the frequency of property damage liability claims and collision claims in countrywide has decreased 11.0 percent and 16.0 percent, respectively, with the loss costs increasing 13.0 percent and 1.4 percent. This helps demonstrate that liability claims and the resulting medical costs are a major source of high and rising auto insurance costs.

Of course, these costs are not uniform between states, or within areas of certain states. For example, in Illinois, the average loss cost for bodily injury liability is $109, compared to the countrywide average loss cost of $119. In the District of Columbia, the average loss cost for bodily injury liability is $191, compared to the countrywide average loss cost of $119. Virginia has an average loss cost for bodily injury liability of $101, and Maryland $144. Some other average loss costs as of the third quarter of 1992 for these areas are: property damage liability: Illinois $65, D.C. $79, Virginia $47, Maryland $62, countrywide $56; collision: Illinois $117, D.C.

$150, Virginia $76, Maryland $104, countrywide $103. These costs are reflected in rates charged in these states.

There also are significant differences in how costs are distributed within states. For example, according to a 1990 report, the bodily injury liability claim frequency per 100 insured cars in Chicago was 3.07 versus the Illinois statewide average of 1.81. This means that bodily injury liability claims were filed 69.6 percent more often in Chicago than for the state, as a whole. Also, there were 52 bodily injury liability claims for every 100 property damage liability claims in Chicago compared to 34 for the state, as a whole. Thus, in Chicago, an injury claim was 55 percent more likely to be filed for each property damage claim, than the average for the state of Illinois.

We understand the role that insurance costs play in limiting access to insurance. We know that rates based on loss experience may be more than some consumers are able to pay. In fact, if insurance is not affordable, it essentially is not available. However, we believe there are rational solutions to problems relating to the cost and the value of auto insurance. One such solution is the development of innovative, low cost products such as our no-frills, no-fault automobile insurance policy proposed in California. With cooperation and creativity we can meet the needs of all consumers, including those who are low-income, by offering them useful and affordable insurance products. If these products are available, and consumers are interested in purchasing them, insurers are sure to increase their marketing efforts to be the company making those sales.

Risk Reduction

To lower cost and increase insurance availability, the risk in some neighborhoods must be decreased. AIA and member companies are working with community organizations such as the Association of Communities for Reform Now (ACORN) on programs such as the ACORN Neighborhood Home and Safety Program to assist communities in lowering their risks, and then providing insurance for those participating residents.

OTHER ISSUES

In recent discussions of redlining, many of the above issues have been raised. Additionally, issues of insurance investment in urban areas, affirmative action within insurance companies and contributions to minority or urban-oriented organizations have been added to the discussion. I would like to address what we are doing in connection with these broader social and economic issues. We are proud of our successes, and would like to mention them. However, we recognize that more has to be done by everyone, including insurers, to help revitalize our urban areas.

Affirmative Action Within Insurance Companies

AIA member companies fund and participate in the recruitment and advancement of minorities through a variety of programs, both external and internal. The external organizations supported by our members include: The Urban League, Black Executive Exchange Program, and SER (Jobs for Progress, Inc.), minority summer internship and scholarship programs like INROADS, inner-city youth job training initiatives like INVEST and the STAG Program. Internal initiatives include targeted college recruitment, company- wide managerial diversity training, the creation of specific, regular opportunities for minority employees to meet and network with top management, minority career development programs, coaching and mentoring programs. Several companies have made an explicit commitment to promote minorities to the highest professional and managerial positions. Some advance the process by auditing the employee mix to ensure representation of the labor pool at large.

In addition to employee opportunities for minorities, many companies also target minority companies as vendors. For example, one AIA member's targeted minority vendors program played a part in 12 percent of the company's 1991 purchases being made through minority or women vendors.

Jobs In Urban Areas

Probably the most important need of urban centers today is jobs for urban residents. Many AIA member companies maintain significant facilities in urban areas across America. Thousands of workers are employed by the insurance industry in cities such as Chicago, Atlanta, Baltimore, Boston, Cleveland, Dallas, Detroit, Los Angeles, Miami, New York City, Philadelphia and Pittsburgh.

Insurance Company Investment in Urban Areas

Related to the issue of jobs is the issue of investment. Insurance industry investment in urban areas is significant. Excluding all other types of insurance invest-

ments in urban areas and only considering the purchase of municipal bonds, the insurance industry has invested billions of dollars a year into urban areas. For example, for the most recent year for which we have data, 1989, insurers held or sold a total of $1.8 billion in various Chicago municipal bonds. For Los Angeles city alone, insurers held or sold $573.4 million in these bonds. For Los Angeles county, insurers sold or held $501.2 million in bonds. The total of all bonds sold or held by insurers as of the end of 1989 for both Los Angeles city and county was approximately $1.1 billion. In addition to these investment dollars, companies also contribute financially to many regional and national organizations dedicated to the advancement of minority interests and the revitalization of American cities. A list of some of these organizations is attached as Appendix A.

These contributions assist not only residents in urban areas, but all of America, by giving urban residents a chance for housing, education, cultural activities, career training, and a host of other opportunities which would not be available without the efforts of corporate America. The insurance industry is proud of its participation in these programs, and intends to look for additional ways to assist in the revitalization of our urban areas.

CONCLUSION

This sensitivity to the benefits of working with minorities and women as employees and managers, as a sales force, as vendors, as customers, and as citizens, is well documented in the insurance industry. We are committed to work with the Congress, state legislators, insurance regulators and consumers to address both broad social and economic and insurance specific problems.

In summary, we oppose redlining. We support the NAIC Unfair Trade Practices Model Act. We support H.R. 1188. Further, we look forward to working with the Senate Commerce Committee as you address these important issues.

APPENDIX A—MINORITY AND URBAN ORGANIZATIONS SUPPORTED IN PART BY INSURANCE COMPANIES

The NAACP
The National Urban League
The United Negro College Fund
Howard University
Livingstone College
Morehouse College
Johnson C. Smith University
Spelman College
Emory College
Hampton University
The Local Initiatives Support Corporation (affordable urban housing)
Martin Luther King Jr. Youth Foundation
Opportunities Industrialization Centers of America
The National Political Congress of Black Women
The National Puerto Rican Forum
The National Society of Black Engineers
The Latin American Association
Las Jovenes
The San Juan Tutorial Program (education, cultural enrichment and recreation for inner city Hispanic children)
National Puerto Rican Coalition
National Council of La Raza
El Hogar Del Futuro, Inc.
Mexican American Legal Defense & Educational Fund
National Urban Fellows
Minority Career Fairs
Neighborhood Housing Services
Center for Community Change
Community Training and Assistance Center
Council for Community Based Development
Low Income Housing Fund
National Minority Suppliers Development Council
Northwest Bronx Community and Clergy Coalition
WAVE Inc.
A Better Chance
Amistad Foundation
Coalition of African American Cultural Organizations
I Have a Dream Foundation
Habitat for Humanity (Atlanta, Newark, NJ)
The Philadelphia Martin Luther King Association for
Nonviolence
United Way
Interracial Scholarship Fund
Y.M.C.A.

Senator BRYAN. Thank you very much, Ms. Schubert. Mr. Bell, we will hear from you next.

STATEMENT OF GERALD BELL, COMMERCIAL LINES SPECIALIST, NATIONAL ASSOCIATION OF INDEPENDENT INSURERS

Mr. BELL. Mr. Chairman, my oral comments will synopsize the written comments you have.

Senator BRYAN. Let me just assure you that your statement, as well as each of the witness' statements that have previously been submitted to us, will be made a part of the record. So we appreciate that.

Mr. BELL. Thank you very much, sir. I will not abuse your time, and read it all.

I represent the National Association of Independent Insurers, a property and casualty insurance trade association of more than 570 member companies, including many small- and medium-size insurers.

We oppose enactment of any Federal insurance data gathering, any collective legislation or mechanism, because it would create a costly, unnecessary Federal response for a problem which, if it exists to any extent, is being adequately addressed at the State level, we believe.

Property insurers are already precluded by State insurance law from discriminating on the basis of race, color, religion, gender, handicap, national origin, and other criteria. And conduct by any insurer of this nature would be unfair discrimination. We abhor such practices, if they exist; we repudiate them, and support the rigid enforcement of the appropriate Federal and State statutes.

The NAIC developed and advocates model laws that require insurers to state why insurers are nonrenewing a policy; and which specially prohibit companies from declining to write insurance solely on the basis of the geographic location of property.

If there are charges of unlawful discrimination, the States through their insurance commissioners are empowered to investigate them; and many of them are doing so. The States also have the power to prosecute companies found to be in violation of such unfair trade practices, and we encourage them to do so.

The States are taking steps to address perceived unfair underwriting and marketing practices, which some call redlining, by insurers.

The NAIC task force on insurance availability and affordability is conducting a three-prong examination of insurer marketing and underwriting practices, which include the following elements:

A data call, by ZIP code, to apply to the 20 States with the 40 largest metropolitan statistical areas. That call includes homeowners, private passenger auto liability which was called for by Commissioner Hunter, dwelling fire, commercial fire, allied lines and business owners' policies of the top 40 personal lines insurers in each State.

It is designed to elicit ZIP code data on premiums, exposures, nonrenewals, cancellations and agent appointments; so that the information sees the light of day to a greater extent than it ever has, and that all the information is on the table.

A comprehensive urban insurance analysis of the data by the NAIC staff, to assess the nature and extent of insurance availability and affordability problems in urban areas, including such factors as claim costs, income and race, and to recommend possible

regulatory and policy measures to address urban insurance problems.

And third, a qualitative analysis of urban insurance problems, including surveys, focus groups, and public meetings, and target examinations of insurers.

States with major urban areas have taken steps to ensure the availability of essential insurance for years, for high-risk properties, by establishing FAIR plans or other mechanisms which are private insurance sector responses which create facilities to spread the cost of writing high-risk property insurance among all licensed property and casualty insurance companies in the State.

FAIR plans currently operate in 30 States and the District of Columbia. Those plans have lost money during the years 1971 through 1991, 20 years in all, with the exception of the year 1987. The specific amount is in the statement; it is close to $1 billion. And insurance companies are assessed for the losses that these plans incur, which exceed the premiums that the policyholders pay.

The proposals which are currently before the House and the Senate impose additional Federal data reporting burdens on insurance companies; and appear to suggest a quota system for agent placement, and type of coverage to be written, without regard to basic underwriting criteria.

Besides being duplicative and extremely costly, the Federal data reporting proposals perhaps represent a first step toward an ill-conceived goal to force insurers to provide the same coverage at the same price, regardless of risk.

Insurers cannot provide identical coverage for different categories of risk, such as older and more fire-hazard and theft-prone properties in certain areas, or rural properties as, again, Commissioner Hunter alluded to, far removed from firefighting and water availability.

Additionally, the legislation would, perhaps, force policyholders who own properties which are in the lower risk categories to subsidize higher risk categories. The insurance industry has historically developed a range of products to fit different risks and make coverage available, based on sound actuarial principles that are designed to avoid, or at least minimized, subsidized rates.

The proposed bills are unnecessary; they are duplicative; they are costly; particularly for smaller regional companies which can ill afford the additional administrative burdens that go hand-in-hand with these proposals.

At this time, when the Nation must be seeking ways to reduce the Federal deficit by cutting Federal spending, the proposed legislation would spawn a new Federal bureaucracy to gather and analyze the information which is already being collected at the State level.

The investigation of alleged insurance redlining is a prime example of a project which should be left to the States, which are already doing the job.

We respectfully urge the members of this committee, Mr. Chairman, to oppose enactment of all of these proposals.

A copy of NAII's background paper on Urban Property Insurance Issues is submitted, which amplifies many of the comments in great detail. Thank you, sir.

[The prepared statement of Mr. Bell follows:]

PREPARED STATEMENT OF GERALD W. BELL

Good afternoon. My name is Gerald Bell and I am the Senior Commercial Lines Specialist for NAII.

The National Association of Independent Insurers (NAII), a property/casualty Insurance trade association of more than 570 member companies, including many small and medium-sized insurers, opposes enactment of any federal insurance data collection legislation because it would create a costly, unnecessary federal response for a problem which, if it exists to any extent, is being adequately addressed at the state level.

Property insurers are prohibited by state insurance law from discriminating on the basis of race, color, religion, gender, handicap or national origin. Conduct of this nature would be unfair discrimination. The NAII repudiates such practices and supports enforcement of the law.

The National Association of Insurance Commissioners (NAIC) developed and advocates model laws that require insurers to state why they are non-renewing a policy, and specifically prohibit companies from declining to write insurance solely on the basis of the geographic location of the property.

A number of states have adopted these models and the NAII continues to support their enactment.

If there are charges of unlawful discrimination, the states, through their insurance commissioners, are empowered to investigate them, and many of them are doing so. The states also have the power to prosecute companies found to be in violation of such unfair trade practice laws.

The states are taking steps to address perceived unfair underwriting and marketing practices (redlining) by insurers. The NAIC Task Force on Insurance Availability and Affordability is conducting a three-prong examination of Insurer marketing and underwriting practices which include the following elements:

(1) A data call by zip code to apply to the 20 states with the 40 largest metropolitan areas (MSAs). It will cover homeowners, private passenger auto liability, dwelling fire, commercial fire, allied lines and business owners1 policies of the top 40 personal lines insurers in each state. It Is designed to elicit zip code data on premiums, exposures, nonrenewals, cancellations and agent appointments.

(2) A comprehensive urban insurance analysis of the data by the NAIC staff to assess the nature and extent of insurance availability and affordability problems in urban areas including such factors as claim costs, income and race, and to recommend possible regulatory and policy measures to address urban insurance problems.

(3) A qualitative analysis of urban insurance problems utilizing surveys, focus groups and public meetings.

States with major urban areas have taken steps to ensure the availability of essential property insurance for high risk properties by establishing FAIR Plans, private sector facilities which spread the cost of writing high risk property insurance among all licensed property and casualty insurance companies in the state.

FAIR plans operate in 30 states and the District of Columbia. In Arkansas and Mississippi the FAIR Plans only provide coverage in rural areas with limited or no water supply and minimum fire suppression capacity. Other Fair Plans, such as the ones in Florida, South Carolina and Texas, provide windstorm and hail coverages only.

Between 1971 and 1991, 20 years In all, FAIR Plans lost money In all years except 1987. In that year the plans barely broke even. The total underwriting loss for all the FAIR plans since Inception Is $992,477,000. Insurance companies participating in the plans are assessed for the losses.

In setting their rates insurance companies look at the characteristics of the properties involved, not at the individual homeowners.

Because the business of insurance is highly competitive, companies must carefully evaluate risks. Some risks, such as the deteriorating condition of a building, or the high risk of a building being vandalized based on past history of thefts in the building itself or in adjacent buildings, cannot be underwritten by competing companies in the voluntary market. These problems are not limited to urban areas. Sometimes, properties in rural areas are rated as higher risks because of the lack of firefighting equipment and nearby water supply to deal with a potential blaze.

The proposals which are currently pending before the House and Senate would impose additional federal data reporting burdens on insurance companies and appear to dictate a quota system for agent placement and type of coverage to be written without regard to basic underwriting criteria.

Besides being duplicative and extremely costly, the federal data reporting proposals perhaps represent a first step toward an Ill-conceived goal to force insurers to provide the same coverage at the same price regardless of risk. Insurers cannot provide identical coverage for different categories of risk, such as older, more fire-hazard and theft-prone properties In urban areas, or rural dwellings far removed from fire fighting equipment, or new suburban properties.

Additionally, the legislation would force policyholders who own properties which are in categories of lower risks to subsidize higher risk categories. The insurance industry has developed a range of products to fit different risks and make coverage available based on sound actuarial principles that are designed to avoid or at least minimize subsidized rates.

The proposed bills are unnecessary, duplicative and costly, particularly for smaller, regional companies which can ill-afford the additional administrative burdens that go hand-in-hand with these proposals.

It is important to understand that insurance companies play an active role in helping inner city residents upgrade their properties, make their neighborhoods safer and their homes more insurable. One specific example is the creation of Neighborhood Housing Services (NHS) a partnership involving insurers, other businesses, local governments and residents, all dedicated to revitalizing inner cities.

NHS services include providing low-income loans and lending assistance, as well as financial, housing rehabilitation assistance and insurance counseling to inner city residents. Since the 1980s, approximately 130 Insurance companies have contributed more than $50 million to NHS projects.

At a time when the nation should be seeking ways to reduce the federal deficit by cutting federal spending, the proposed legislation would spawn a new federal bureaucracy to gather and analyze the information which is already being collected at the state level. The investigation of alleged insurance red lining is a prime example of a project which should be left to the states which are already doing the job.

We respectfully urge members of this committee to oppose enactment of these proposals. A copy of NAII's background paper on Urban Property Insurance Issues is submitted for the record. This document expands on the thoughts outlined above and offers a few constructive steps public policymakers might consider to promote property insurance availability.

Senator BRYAN. Thank you very much, Mr. Bell. Mr. Bhargava, we will have you bat cleanup here on this panel.

STATEMENT OF DEEPAK BHARGAVA, LEGISLATIVE DIRECTOR, ASSOCIATION OF COMMUNITY ORGANIZATIONS FOR REFORM NOW

Mr. BHARGAVA. Thank you, Mr. Chairman. I am Deepak Bhargava, legislative director of ACORN; and I am happy to be here today. Thank you for having me.

The problem of insurance redlining has been on the table for over 25 years. It reemerged, as Commissioner Hunter said, after the riots in Los Angeles, when the California Department of Insurance found that consumers in minority neighborhoods in Los Angeles either could not get coverage, or were paying exorbitant rates, or were being covered by surplus lines carriers that, eventually, defrauded them.

And this is a great irony, since the 1968 riots in many communities around the country led to the formation of the Hughes Presidential Commission on Insurance Availability; which found a substantial problem, and concluded that: "communities without insurance are communities without hope."

So, more than 25 years later, we have not made much progress.

ACORN's own study of homeowners' insurance discrimination last year found that residents of predominantly minority neighborhoods often find it difficult or impossible to get quotes from agents; are more likely to be steered to FAIR plans or to substandard policies which offer limited coverage at a higher price; and often face

requirements, for example, inspections or credit checks, that are not required of other applicants.

Testing by the National Fair Housing Alliance, which resulted in two complaints against major insurance companies, found discrimination in the provision of homeowners' insurance to be pervasive.

In comparing the treatment of applicants for similar homes of similar value with similar income neighborhoods, they found that African-American testers experienced discrimination 47 percent of the time in Louisville; and 60 percent of the time in Atlanta and Milwaukee. And Latino testers in Chicago experienced discrimination upward of 95 percent of the time, in the tests that were conducted.

Many insurers claim that such disparities are due to risk, rather than to prejudice. I think it is important to note the only study in this area was done by the Missouri Department of Insurance in 1993, which found that homeowners in low-income minority areas pay more for policies than homeowners in low-income white areas; but the losses in minority areas over a 5-year period were significantly less than in white areas.

So, this study suggests that the insurance industry's contention that underwriting is extremely precise, and based solely on risk, may not be accurate.

And it is also worthwhile pointing out that flagrant discrimination is not uncommon or unusual. The NAACP lawsuit in Milwaukee against the American Family Mutual Insurance Company rested, in part, on a conversation between a sales manager for the company and an insurance agent.

The conversation went as follows:

> Very honestly, I think you write too many blacks. You have got to sell good, solid, premium-paying white people. They own their homes, the white works. Very honestly, black people will buy anything that looks good right now; but when it comes time to pay for it, you are not going to get your money out of them. The only way you are going to correct your persistency is to get away from the blacks.

I would urge this committee to consider and to pass legislation that would, as a modest first step, require insurance companies to disclose information comparable to that collected by banks under the Home Mortgage Disclosure Act.

This would serve three purposes: First, the administration has stated that data collection would assist an enforcement of Federal civil rights laws, such as the Federal Fair Housing Act; second, it would resolve the dispute, the ongoing dispute between the insurance industry and advocacy groups about whether this problem exists; and lastly, as you know from your work on the Banking Committee, even disclosure could have a remarkable impact on industry practices, as has been the case with HMDA over the past few years.

I would simply endorse what Mary said about the contents of disclosure: That it should be done at a census tract basis, in as many MSAs as possible, and with the race and gender of policyholders.

Let me, last, comment on the efforts of the NAIC. I think the record of the NAIC, and consumer protection in general, leaves something to be desired. In this area, it is an absolute scandal.

The NAIC has not moved on this issue, despite abundant evidence, for over 2 decades. The data call to which the two witnesses

spoke was initiated only after the Federal Government moved in this area.

And I might note that the NAIC is not collecting data on losses; which is absolutely essential, to get at the bottom of this problem.

So, I will not keep you any longer. Thank you for the opportunity to testify.

[The prepared statement of Mr. Bhargava follows:]

PREPARED STATEMENT OF MR. BHARGAVA

Good afternoon, Mr. Chairman, and members of the Committee. I am Deepak Bhargava, Legislative Director of ACORN. We sincerely appreciate the opportunity to present testimony before you today on the important subject of insurance redlining. We appreciate the Committee's attention to this problem, and congratulate you for your willingness to address it.

1. INSURANCE REDLINING: A REVIEW OF THE EVIDENCE

The existence of insurance redlining has been documented by numerous studies, commissions and panels over the course of two decades. We define insurance redlining as the industry practice of refusing to write policies, charging differential rates, offering substandard coverage, discouraging applications, or imposing differential requirements as a condition of coverage based on the geographic location of a property or individual seeking coverage.

Insurance redlining in practice means that minority and low-income neighborhoods are underinsured; consumers in these neighborhoods receive lower-quality coverage at a higher price than policyholders in high-income or predominantly white areas and are more likely to be covered by FAIR plans; policyholders in minority and low-income areas are more likely to have their policies canceled or non-renewed by a carrier, and to have their claims contested.

Numerous studies have found that the racial composition of a neighborhood is an independent factor influencing underwriting decisions, even after other criteria, such as income, the number of rental and owner-occupied units, the incidence of fire and crime, and the age and value of dwellings are accounted for.

Studies in these areas have consistently documented several factors which account for these disparities.

(1) Applicants from predominantly minority and low-income areas are often "pre-screened"—or discouraged from seeking coverage.

Results of phone surveys to agents from applicants posing as residents from neighborhoods of different race compositions and income levels show significant disparities. Applicants from low-income and minority neighborhoods are often simply not offered quotes over the phone, or face stiffer requirements as a condition of coverage than residents of other neighborhoods.

(2) Insurers use discriminatory underwriting criteria.

Although no insurer is allowed to use race as an underwriting criteria, the use of criteria such as the value of the dwelling, the age of the dwelling or its construction type have the effect of redlining areas with high concentrations of low-income and minority households. Such criteria may be established by carriers at certain thresholds precisely in order to exclude certain neighborhoods.

In some cases, agents may be instructed by companies to avoid writing policies to people in certain professions—those in which minorities are more likely to be represented. Additionally, many underwriting guidelines use excessively subjective contents such as "lifestyle" or "morals" that invite discrimination.

(3) Insurers use discriminatory rate setting methods.

Basic rates for property insurance are primarily established by rating territory. Larger companies in particular may create territories that effectively carve up a city according to the racial and income characteristics of neighborhoods—thereby allowing for wide disparities in premiums charged.

(4) Agents are underrepresented in low-income and minority neighborhoods.

The number of agents selling policies in a zip code varies sharply based on the racial and income composition of a neighborhood, even after other factors are taken into account. And changes in the racial composition of a neighborhood may lead to dramatic shifts in the number of agents located there.

(5) Policyholders in low-income and minority areas are treated as second class consumers by many carriers.

Policyholders in minority and low-income neighborhoods are more likely to have their claims disputed, as well as have their policies canceled or non-renewed without

reason, or for reasons which would not result in the termination of a policyholder in a high-income or predominantly white area.

(6) State regulators are unable and often unwilling to stop these practices.

State insurance departments are often underfunded and understaffed, and the pro-industry bias of many departments leaves many anti-discrimination laws effectively unenforced, and many consumers without recourse.

(7) FAIR plans and assigned risk pools—created to be the insurer of last resort—may in fact be used as "dumping grounds" for whole neighborhoods.

A disproportionate number of homeowners in minority and low-income areas are assigned to the residual market The policies available in this market are often limited to fire and extended coverage, usually do not cover the insured for full replacement cost, and may cost as much as 270 percent more than the conventional market.

(8) Abandonment by the large insurers has created a niche for unregulated surplus lines carriers.

Surplus lines carriers—or "scavenger" companies—are chartered offshore, and may avoid state regulation as well as insurance by state guarantee funds. These specialized carriers may aggressively market policies in low-income and minority communities, sometimes leaving consumers altogether unprotected in case of a major claim.

These problems have been documented over the past twenty five years in numerous studies and in litigation. Below is a summary of some of the relevant research and litigation.

HUGHES PANEL—INSURANCE IN RIOT AFFECTED AREAS (1968)

The first federal investigation of the urban insurance crisis was conducted by the Hughes panel in 1968. Concerned that the outbreak of the now historic urban riots would lead to a mass flight of insurers from the inner city, the panel was appointed to study the cause and effect of the availability crisis, and make recommendations for its remedy.

What the panel concluded, however, was that "[r]iots [were] only one aspect" of the availability crisis. In the words of David Badain, "[t]he panel in fact found that the industry was one which 'exaggerated its urban loss experience' and manifested its view in underwriting manuals warning of excessive inner-city risks. As these views were accepted by underwriters and agents, insurance in these areas became less readily available, and the cycle of deterioration continued."

The results of this exodus by the insurers, as the panel predicted, has been to create additional incentives for those inner-city residents who can afford to relocate to the suburbs to do so.

For those people who can not afford to leave the result has been to further erode the incentive to maintain their property. The panel predicted this as well, and warned the country that "[i]nsurance must be available now."

FEDERAL INSURANCE ADMINISTRATION: FULL INSURANCE AVAILABILITY (1974)

In 1974, the Federal Insurance Administration issued a report entitled "Full Insurance Availability" which was highly critical of the FAIR plans. Indeed, it found that only 4.8 percent of the 3 million FAIR policies then in effect had actually reported losses, indicating that the "the vast majority of the insureds in the plans should have been written voluntarily."

U.S. COMMISSION ON CIVIL RIGHTS (1979)

In Insurance Redlining Fact not Fiction, a report of the Illinois, Indiana, Michigan, Minnesota, Ohio and Wisconsin Advisory Committees to the U.S. Commission on Civil Rights, in 1979, the same problems with availability, quality and affordability were documented.

The Committee also performed a zip code analysis of policies written in Chicago, similar to that performed by ACORN, and had similar findings. The study examined the level of coverage by the conventional market and FAIR plans, and compared these figures to the racial composition of the zip codes, controlling for the age of housing, family income levels and the incidence of fires and thefts.

Of all factors considered, coverage levels were most closely correlated with the racial and income composition of neighborhoods, for both the conventional market and FAIR plans. This correlation remained significant even after controlling for the differential incidence of fire and theft by neighborhood type.

STUDIES BY PROFESSOR GREGORY SQUIRES (1980'S)

Professor Gregory Squires, of the University of Milwaukee, Wisconsin, has been the leading academic researcher on the problem of insurance redlining for two decades. He drafted much of the study submitted to the U.S. Commission on Civil Rights, and has also recently performed similar studies on the availability and cost of insurance. The methodology of these studies has included both statistical analysis of zip code data in Milwaukee, phone testing of agents, and analyses of agent locations by zip code.

The results of the statistical analysis Professor Squires recently performed for Milwaukee those the results of his study for the U.S. Commission on Civil Rights a decade earlier. Squires found that:

"Racial composition was associated with the number of policies written per owner-occupied dwelling more highly than income, poverty rate, age or condition of housing, population turnover, crime rate, incidents of fire, and other factors presumably associated with risk. More importantly, racial composition remained statistically significantly associated with the distribution of insurance policies even after these other variables were controlled."

Prof. Squires has also performed testing similar to that conducted by ACORN, and found that:

"In testing programs we have carried out in Milwaukee with the Metropolitan Milwaukee Fair Housing Council and others have done in cities throughout the United States, residents of minority communities have been discouraged while residents of predominantly white neighborhoods have been encouraged to do business with insurance agents. Despite limitations in available data and the methodologies often employed, the overwhelming conclusion of existing research is that there is a racial gap in the availability of property insurance. While some of this gap can be accounted for by financial considerations of insureds, conditions of properties, and risk related factors generally, the racial gap remains substantial even after these factors are taken into consideration.

Another example given by Prof. Squires is the correlation of agent location to the racial composition of neighborhoods, which he found to be significant in Milwaukee in 1970, 1980, and 1990, even after taking into consideration the number of owner occupied housing units, the age and condition of homes, and the income of the residents. A striking example was of the Sherman Park neighborhood on Milwaukee's west side, which changed from 1 percent non-white to 24 percent non-white between 1970 and 1980. Over this same period, the number of insurance agents declined, from 22 to 9.

Prof. Squires has also uncovered the following statements from company underwriting manuals and guides:

"Coverage may not be bound on the following classifications without prior approval * * * professional athletes, musicians or entertainers.

"Following occupations not to be approved for preferred policies: janitors, stewardesses, traveling salesmen, auto salesmen (particularly those associated with used cars sales), musicians, athletes, etc.

"RED FLAGS FOR AGENTS AND CLAIMS PERSONNEL * * *

"a. Declining property values * * *

"b. Population or racial changes."

Perhaps the most ludicrous example was of the one agent who was told to avoid members of the clergy for automobile insurance because they "tend to place their faith in the Lord when driving."

ILLINOIS PUBLIC ACTION COUNCIL (IPAC) (1991)

A report from the Illinois Public Action Council (IPAC) found that both State Farm and Allstate, in their auto insurance practices, had "redlined by not placing agents in all city neighborhoods and not providing phone quotes to callers from certain areas." In fact, neither of these companies had any agents in the west and mid south areas of Chicago. The total area redlined by these companies covers over 85 square miles of the city.

PENNSYLVANIA PUBLIC INTEREST COALITION (1991)

The Pennsylvania Public Interest Coalition found similar results for auto insurance. Agent locations and the likelihood of being offered coverage or a quote over the phone differed significantly based on the race and income of neighborhood.

NAACP LAWSUIT (1992)

Recently, the NAACP won a major victory in a class action suit charging a Wisconsin insurer with discrimination in the sales of insurance. The NAACP case is the first time a federal appeals court has ruled that the Fair Housing Act prohibits bias in the underwriting and sales of homeowners insurance. The suit charged that American Family, the largest underwriter in Wisconsin, was redlining parts of Milwaukee. It also alleged that the company was charging higher premiums to nonwhites for properties of comparable value and risk, instructing agents to avoid selling policies to blacks and failing to locate offices in black neighborhoods.

The suit has now been sent back to a lower court to determine whether the discriminatory practices did occur as defined by the federal Farr Housing Act and state law. It must also be noted that the appeal court's ruling only applied to rates shown to be based on race, rather than actuarial classifications. The ruling did not make a judgment as to whether risk classifications having a disparate impact on members of a racial or ethnic group are illegal under the Fair Housing Act.

The following quote is from a sales manager for the American Family Insurance company advising several agents in 1988:

> "Your persistency went down the shitter * * * very honestly, I think you write too many blacks * * * you gotta sell good, solid premium paying white people * * * they own their homes, the white works * * * Very honestly, black people will buy anything that looks good right now * * * but when it come to pay for it next time * * * you're not going to get your money out of them * * * the only way you're going to correct your persistency is get away from the blacks."

OFFICE OF PUBLIC INSURANCE COUNSEL (OPIC) (1993)

OPIC is an independent state agency representing Texan insurance consumers. OPIC recently undertook an investigation of the distribution of the Texas Auto Insurance Plan (TAW) policies, the state assigned risk plan, and also looked at the agent distribution of some of the largest underwriters in Texas.

The TAIP's population increased from 250,000 to 750,000 from August 1991 through July 1992, partly as a result of stricter enforcement of the mandatory insurance laws, and partly as a result of tighter underwriting guidelines by the conventional market. Zip code analysis of the location of these policyholders revealed, once again, that the likelihood of being in the TAIP had more to do with the race or income levels of one's neighborhood than with one's driving record. Zip codes with minority composition twice the state average had 1.5 times as many TAIP policies. Zip codes with minority compositions four times the state level had TAIP concentrations of twice the state average.

OPIC found no significant risk associated reasons for these disparities. As the TAIP offers minimum liability, crime levels in different neighborhoods are irrelevant to an insurer's risk. In fact, it seems that the primary reason for the unwillingness of conventional insurers to insure low-income people is that the latter are less likely to buy excess liability limits, homeowners and life insurance as part of a package.

Another example of the subjectivity of insurance underwriting requirements is the use of the "no prior" rule. When enforcement of state required insurance laws were enforced, many companies refused coverage to people who had previously held insurance. Preliminary analysis of the "no priors" however, indicate that loss per exposure is in fact 17 percent lower for "no priors" than for "priors", and about 25 percent lower for "no priors" than for "no needs".

OPIC also analyzed the location of the location of State Farm agents by zip code, and found that zip codes without agents consistently had higher minority concentrations, even for zip-codes with populations over 10,000.

MISSOURI DEPARTMENT OF INSURANCE (1993)

The Missouri Department of Insurance's 1993 study of zip code level policy information revealed that residents of low-income minority zip codes in St. Louis and Kansas City paid more for coverage than residents of low-income white zip codes in those two cities, and were more likely to receive "limited" as opposed to "standard" policies. Yet, the loss ratio in low-income minority neighborhoods was significantly less than in low-income white areas.

For example, homeowners in low-income minority areas in St. Louis paid $7.30 per thousand dollars of coverage, compared to $4.65 in low-income white areas. Yet the loss ratio in low-income minority areas was 57 percent, compared to 72 percent in low-income white areas.

This study is especially significant, because it suggests that the usual response from the industry to charges of redlining—higher risk in low-income areas—may not adequately explain disparities in underwriting patterns.

CALLAWAY V. ALLSTATE (1993)

Under proposition 103, coverage is guaranteed to all Californians with good driving records with the insurer of one's choice. According to a former employee of Allstate, however, the company launched a policy of systematically and deliberately evading this mandate. Employees were instructed to discourage applicants with good driving records who were otherwise considered "undesirable", and to lose the applications, or place them in a storage area to be ignored if the client persisted in his or her application.

Sales agents were also required by management to comply with a series of conditions which were virtually impossible to achieve in order to discourage applications for coverage by urban and minority applicants. Management also ordered its employees to close Allstate offices in selected urban and minority communities to avoid applications from prospective insureds in these "undesirable" areas. Employees were also instructed to include life insurance with homeowners policies without informing the client, and also refused to notify policyholders that the "guaranteed replacement cost" provisions did not cover personal property, knowing the client would be misled.

The plaintiff in this case was a rising executive who objected to these policies, was subsequently laid off, and given a monthly payment in exchange for his secrecy. He filed suit after Allstate allegedly stopped making payments.

OFFICE OF PUBLIC INSURANCE COUNSEL (1994)

A 1994 OPIC study A Review of Homeowners Insurance Underwriting Guidelines Used in Texas found that:

- companies representing 91 percent of the homeowners market employed minimum coverage amounts, and 88 percent had age of house restrictions;
- companies representing 60 percent of the market had restrictions based on the location of property; and
- 29 percent had restrictions based on "lifestyle" or 'bad morals."

TOLEDO FAIR HOUSING CENTER (1992-93)

The Toledo Fair Housing Center, has been investigating claims of insurance redlining and has conducted phone testing of Toledo insurers. Their findings are consistent with those from other studies. Confronted by a common refusal to insure properties valued at less than $30,000, the Center examined the impact such a policy and found that the policy has a disparate effect on 78 percent of the African-American community, 74 percent of the Hispanic community and 30 percent of the Caucasian community in the city of Toledo. The impact on the MSA would be, respectively, 71 percent, 40 percent and 12 percent.

The Center has also been investigating claims discrimination, and while complete results are not yet available, has found discrimination in 95 percent of the investigations conducted. In these studies, the Center has been using similar residences with property owners of different races, and has even given the Caucasian property owners properties in a markedly inferior state. The center has found a clear pattern of discrimination.

NATIONAL FAIR HOUSING ALLIANCE (1994)

In May, 1994, the National Fair Housing Alliance filed complaints with HUD against Nationwide and Allstate charging illegal discrimination under the Fair Housing Act. NFHA's testing revealed that:

- In Louisville, African-American testers experienced discrimination 47 percent of the time;
- In Atlanta, African-American testers experienced discrimination 60 percent of the time;
- In Milwaukee, African-American testers experienced discrimination 60 percent of the time; and
- In Chicago, Latino testers experienced discrimination 95 percent of the time.

NFHA found that a wide range of discriminatory practices exist in the industry, including: use of minimum insurance amounts and maximim age requirements; credit checks for minority applicants, but not white applicants; and inspection requirements for minority applicants, but not white applicants.

MISCELLANEOUS EVIDENCE

An article by Peter Kerr of the New York Times documented the prevalence of offshore "scavenger" companies, who prey upon the underinsured inner city. In the wake of the Los Angeles riots, Kerr surveyed business owners and found that a large portion of policies written to businesses in south-central Los Angeles were written by "surplus line" carriers, or "scavenger companies". These insurers, who offer policies at a much higher cost than mainstream carriers, licensed offshore and avoid state regulations almost entirely. Often, when huge payments become due, their address may turn out to be little more than a post office box, and the policyholder is left holding a worthless piece of paper.

John Garamendi, the Insurance Commissioner in California, recently fined a California insurance company, based on evidence supplied by an agent. The agent supplied a map which had the minority and low-income portions of San Francisco outlined in yellow highlighter. The agent claims that the mid-sized carrier who sent him the map instructed him not to write policies in any of the highlighted areas. The Texas and Missouri insurance departments have also taken enforcement actions against insurance companies for illegal discrimination.

Despite the lack of readily available data on the subject, scores of investigations by academics, interest groups and governmental agencies have come to the same conclusion: insurance redlining is indeed "fact—not fiction." The insurance industry's methodological arguments with the results of these studies over the course of three decades only underscores the need for systematic disclosure of data by the insurance industry.

2. "A POLICY OF DISCRIMINATION?": FINDINGS OF ACORN RESEARCH

On February 5, 1993, ACORN released a study on the availability, quality and cost of residential insurance in fourteen major cities. The study, the first of its kind, combined a statistical analysis of insurance company filings by zip code in 5 cities with the results of extensive testing in 13 cities.

The statistical analysis was performed in four states currently requiring such disclosure of property and casualty insurance companies—disclosure similar in kind to the federal Home Mortgage Disclosure Act (HMDA) filings required of banks. It compared the number of homeowners or other personal dwelling policies written by the industry in various urban and suburban zip codes to demographic data on race and income of neighborhoods. The study also looked at the quality of coverage in neighborhoods of different racial and income compositions.

The second part of the study consisted of the results of extensive testing of various insurance agents and underwriters in thirteen cities. Testers attempted to obtain quotes for insurance-from both captive and independent agents for properties in different neighborhoods—including low-income, generally minority urban areas, upper-income predominantly white urban areas, and suburban areas. Information on disparities in the ability of callers to get quotes and to get the premium policy, and differences in prices of policies and the frequency of required inspections was then compiled.

Among the key findings of the study are that:

(1) Test callers from minority neighborhoods were refused a quote on a policy 38 percent of the time. compared to 7 percent of the time for callers from white areas.

Callers from low-income areas were often plainly told by agents that "we don't write policies in that area", or "we don't write policies for properties of that value." In some cases, testers were told they would have their call returned at a later time with a quote—promises that were rarely kept.

(2) Insurance policies written in low-income and minority neighborhoods tend to be of substandard quality.

Callers from low-income neighborhoods were offered "market value" policies—policies which do not cover the property for the full replacement costs in case of damage. They were also offered FAIR plan policies more frequently than callers from high-income areas. FAIR plan policies are often of substandard quality and usually cost substantially more than conventional policies—270 percent more in Missouri, for example.

(3) Test callers from low-income neighborhoods were quoted rates averaging 2.5 times higher, relative to their level of coverage, as test callers from upper-income neighborhoods.

These figures were based on quotes given by agents to testers, relative to the level of coverage offered.

The results of this study seem to indicate problems as serious in its dimensions as those identified by the Hughes panel in 1968.

3. FAIR PLANS—A FAILED SOLUTION

FAIR plans were established on the recommendation of the Hughes panel. For those states in which the industry voluntarily set up shared risk pools for "high risk" insureds, the option of Federal Riot Reinsurance was made available. This reinsurance was offered at a lower rate than was available on the open market, to companies which participated in the FAIR plans. FAIR plans were explicitly created to be the insurer of last resort.

But problems with the FAIR plans rapidly made themselves apparent In New York, for example, they were required to operate at cost, thereby essentially nullifying their goal and begging the question of what purpose the discounted Federal reinsurance fulfilled. In most states, FAIR plans were also substantially more expensive than the conventional market—300 percent more in New York, according to a 1979 Aetna study. Also, FAIR plans often only offer limited coverage as opposed to full homeowners coverage.

It also became apparent that the FAIR plans had become a dumping ground for whole areas, as opposed to identifiably high-risk individuals—areas that the underwriters just don't want to spend the time evaluating independently. Thus, rather than being used for riot stricken areas, or high risk individuals, FAIR plans were used by companies to avoid any policyseeker perceived to be high-risk, simply by virtue of his or her zip code. A 1977 study by Robert Abrams revealed that 45 percent of Bronx residents and businesses were covered by FAIR plans or "surplus line carriers". ACORN found this in its analysis as well, with low-income, minority areas accounting for almost 70 percent of the FAIR plans written in St. Louis. In Detroit, all our test callers who sought insurance anywhere in the city were solely offered FAIR plan policies.

Little has therefore changed since 1976, when a report by the Detroit city council President, Carl Levin, found that in many instances "Detroiters cannot obtain insurance in the private market at all and must purchase insurance in the property pool. Insurance purchased from the pool is more expensive and provides less coverage that in the private market."

The claim that many low-risk families were being burdened with the FAIR plan has been supported by statistical analysis. In New York, only 4.8 percent of FAIR plan policy holders reported any claims, according to testimony before the Judiciary committee in 1978. ACORN's preliminary analysis of 1991 zip code data in St. Louis and Kansas City, Missouri, found that only 6 percent of FAIR plan policy holders reported claims, compared to 12 percent of conventional policy-holders. Similarly, NY PIRO found in 1978 that only one-third of the FAIR plans in New York had any surcharges—implying that, upon inspections, the majority turned out to be well maintained properties.

FAIR plan policy holders were thus being offered inferior coverage at a greater price—and those policyholders who were unfairly grouped in these programs were alone in bearing the cost of higher risk properties, while the conventional market made even more money. It is in this sense that FAIR plans are only one of the many subtle mechanisms for redlining. People are redlined out of the conventional market, only to find themselves rated out of the residual market

The Boards governing FAIR plans frequently have little public input. The Board of the New York Auto Insurance Plan, for example, consists of fifteen members, eight of which are insurance company representatives, and seven of whom are "public members." However, these public members must be appointed and elected by the rest of the board, making their independence open to question. Not a single member of the Governing committee is a resident of the neighborhoods where most of the clients of the plan reside.

Clearly, FAIR plans did not solve the insurance availability crisis predicted by the Hughes panel, but it would be a mistake to blame this failure on the FAIR plans themselves. Rather, these problems suggest a problem with the functioning of the conventional market that has changed very little since the investigation by the Hughes panel. Indeed, it might be argued that the creation of FAIR plans served to deflect attention from gross abuses within the industry, and to defer much needed reforms.

4. STATE REGULATION: INADEQUATE AND INEFFECTIVE

A few states have passed anti-redlining statutes. However, these are usually fairly ineffective, and poorly enforced. The NAIC model laws language for anti-redlining statutes suggests that states prohibit "refusing to insure" someone based solely on their geographic location. Some states also make cancellations subject to that restriction. Discrimination on the basis of race is illegal in all states, sometimes spe-

cifically in reference to insurance, sometimes through more broad based civil rights or unfair trade practices laws.

The wording of these laws leaves companies excessive latitude. Broad based redlining and anti-discrimination laws, for example, do not prohibit or restrict the use of underwriting criteria which have the effect of redlining or discriminating against minorities. And the enforcement of these laws has been less than aggressive.

The most comprehensive legislation addressing redlining was enacted in Michigan. This statute requires that the owner of any building meeting property code may obtain premium coverage with the insurer of his or her choice. FAIR plans are also available, and offer full coverage at a price which reflects the average price of similar conventional policies. Michigan also has a cap on the difference in territorial rates any company may set, and limits the number of territories to three. In some respects, the Michigan law sets the standard for the nation.

Nevertheless, an ACORN member from Detroit was repeatedly refused coverage by one insurer, and referred to the FAIR plan—yet she was never asked whether her property was up to code. When she asked to speak to the agent's supervisor, he informed her that coverage could be made available, but it would cost three times as much as the FAIR plan. Indeed, every test caller from the city of Detroit in our study was referred to the FAIR plan. Clearly, then, such laws make little difference if they are not enforced.

California has passed some of the most aggressively pro-consumer legislation in recent years. Proposition 103, enacted by the voters as the insurance reform initiative, obliged insurers to insure all good drivers, and prohibits any rate that is unfairly discriminatory. Commissioner Garamendi has also been working on anti-redlining regulations which emphasize a "carrot and stick" approach. Under these regulations, an insurer with a bad record of providing coverage in inner city areas is financially penalized, via a decrease in the amount of profit permitted in rate approvals. Insurers who play by the rules are given a bonus. Despite the industry's claims that market incentives, and not prohibitions are the way to solve the insurance availability problems, few insurers have expressed support for these regulations.

The current system of state level regulation is insufficient and inadequate. According to a 1988 report by the Consumer Insurance Information Group (CIIG) and the Association of Professional Independent Agents (PIA National), insurance departments have inadequate resources to regulate carriers. Four states, New York, California, Florida and Texas, control more than half of all funds and staff dedicated to insurance regulation in the country.

The report also showed that the average department has less than four actuaries—the individuals charged with assessing risk and evaluating company rate filings. This pales in comparison to the number of actuaries analyzing and filing the rates for the insurance companies. In Chicago, the rate filing manual for one company may be as long as 1500 pages! It the insurers' risk analysis is faulty or based on prejudice, it is unlikely that the insurance department would ever find out.

Years earlier, a similar criticism was made by then Detroit City Council President Carl Levin, regarding the time constraints facing the department when evaluating rate hikes. "These rigid time constraints are a substantial problem in the rate making process. The insurance bureau receives approximately 7500 filings each year, about 1500 of which request rate increases, and has five staff people available to review them. The time pressures and the sheer volume work against an adequate review of all rate increase requests."

And the departments do seem to be a little too close to the industry. Another PIA study showed that at least 38 percent of insurance commissioners had worked for the industry prior to serving the state, while almost half would work for the industry after serving an average of only 3.3 years. Also, less than a fourth of the states have elected officials who are directly responsible to consumers of insurance.

Last year, an article in the Washington Post made these ties explicit The NAIC, which was planning a meeting in the Washington, D.C. area sent a letter to several of the larger local insurers requesting contributions, accommodations and even golf tee times from the industry.

Another example can be seen in the saga of the New York disclosure law. Originally, disclosure of homeowners policies was to be provided to the commissioner by zip code. However, because of complaints by the industry, this requirement was changed by regulation to require only disclosure by county. This change rendered the data virtually useless in determining urban availability problems.

In fact, when ACORN tried to gain access to this data, we were informed that it had not even been examined, due to staff shortages, and that it was the custom of the department not to make it publicly available until it had examined the data itself. When we pressed the issue, we were then informed that not all the data could

be provided to us anyway, because some companies requested the data not be made publicly available This denial was in spite of the fact that the statute explicitly states that the data shall be made accessible to the public. When ACORN mentioned this point, we were told they were aware of this legal obligation, but that they usually withheld the information anyway, because they like "to stay on the companies' good side"!

The NAIC only responded to the public outcry over redlining that followed the 1992 Los Angeles riots after Congress stepped in—as a way of preserving turf. The NAIC's secretive and closed procedures have fed mistrust among the public. The data call they have initiated will not result in credible data of the necessary specificity. The unwillingness of the NAIC or most individual states to release this data to the public for independent analysis further undermines the credibility of the state response. We firmly believe federal action in this area is needed.

5. INSURANCE REDLINING AND ECONOMIC DEVELOPMENT

Overpriced and substandard quality insurance contributes to abandonment and urban decline, and leaves urban businesses and residents poorly situated to compete with their suburban counterparts. This dilemma is illustrated by the response of one of the trade groups to our recent study. A spokesperson for the group argued that "[o]f course insurance is more expensive in inner cities. But so are groceries." Unfortunately she had it reversed—it is groceries that are made more expensive because insurance is more costly in urban areas. Indeed, there is probably no single product—including groceries—which is as regressive in its impact on low-income households.

The development of thriving neighborhoods with expanding opportunities for homeownership and entrepreneurship hinges on the availability of credit and insurance. Mortgage lenders will often not make loans without property insurance—no insurance means no home. And, high-priced insurance acts as a real deterrent to the creation of affordable housing for low- and moderate-income families. Residents of low-income and minority neighborhoods face additional hurdles in achieving a better standard of living in the form of homeowners and auto insurance rates that may be several times that of their suburban counterparts.

In addition, any urban aid or enterprise zone legislation will be a foregone failure without affordable insurance. A small business cannot remain competitive with its suburban counterparts if its insurance costs twice as much, and without adequate insurance, a small business cannot risk expansion. And the jobs that do exist are made inaccessible by over-priced auto insurance.

The first presidential commission on insurance availability put it simply: "communities without insurance are communities without hope."

6. RECOMMENDATIONS

We believe that the first step in addressing the problem of insurance redlining is the collection of data comparable to the Home Mortgage Disclosure Act (HMDA). Such data collection will serve multiple purposes. First, it will allow for an objective analysis of insurance underwriting disparities, and provide insight into the causes of those disparities. Second, it will assist state and federal regulators in enforcement of the anti-discrimination laws. And lastly, in much the same way that the sunshine introduced by HMDA has transformed mortgage lending practices, insurance disclosure would allow for critical self-analysis by the industry. We strongly support legislation introduced by Senator Russell Feingold (D-WI), S. 1917, and urge the Committee to move on comparable legislation.

We believe that insurance legislation should require disclosure of the number, price and type of policies sold for automobile, homeowners and commercial insurance for small business on a census tract basis, and by the race and gender of policyholders. Information should be collected in all Metropolitan Statistical Areas (MSAs) to ensure that groups protected by state and federal anti-discrimination laws will benefit from the legislation. Finally, the legislation must require reporting of information on loss data to resolve the dispute over the extent to which identified disparities in underwriting practices reflect risk or prejudice.

In addition, we are greatly encouraged by the public statements of HUD and the Justice Department that they intend to vigorously enforce the federal Fair Housing Act as it applies to residential property insurance.

We appreciate the Committee's attention to these important issues, and look forward to working with you to craft appropriate legislation.

Senator BRYAN. Thank you very much, Mr. Bhargava. Let me begin with you, a question: In your view, is risk, is that a relevant factor, in terms of an underwriting standard?

Mr. BHARGAVA. Yes, it is.

Senator BRYAN. Tell me a little bit about the Missouri study. Because you indicate that—that is, at least exhibit A in your argument—that at least in some instances, risk is not the criteria; because in those areas in which there were low-income whites, where the risk of loss was greater, they actually paid lower premiums, if I understood your testimony, than a comparable neighborhood of minority where the risk was less but the premium structure was higher.

Was that the essence of what you said?

Mr. BHARGAVA. That is exactly right. In their analysis of data from St. Louis and Kansas City, they found that the average premiums per $1,000 of coverage were substantially higher in minority neighborhoods of the same income; but that the loss ratio was substantially lower. And that was data over a 5-year period that they looked at.

Senator BRYAN. Who did that study?

Mr. BHARGAVA. That was the Missouri Department of Insurance, based upon ZIP code data they have been collecting since 1978.

Senator BRYAN. Mr. Bell, what is your response to that? Do you think the Missouri study is flawed?

Mr. BELL. Yes, I do. I have read the study. It is our view that the staff of the Missouri Department has manipulated and misinterpreted data, to support their preconceived conclusion.

It is interesting that the same ACORN report that triggered the Missouri study also triggered a Minnesota study. The Minnesota Department of Commerce just released their analysis. They looked at over 4,000 instances of insurers refusing, canceling, or not renewing homeowners' coverage, because they wanted to know the facts.

And, after they completed their study, they reported that over 97 percent of the actions that they reviewed over those 4,000 items complied with all of the applicable antiredlining statutes. Of the remainder, most of the violations were technical in nature.

They determined that out of the, I think it was 4,100 and some, there were only 12 that might be considered redlining, according to the Department; and they are not sure of those, and they are investigating them.

So, redlining is, I suggest, still a matter of perception. Of course, one can argue that perception is reality, I suppose. But clearly, there are urban property insurance issues of great magnitude that have to be addressed.

I think the insurance industry is going about it, in addressing the issues, identifying the issues, in diverse ways; States are addressing it differently; this Congress is addressing it in various ways; because we have a concern for the problem.

But I feel that, getting back to your specific question, that Commissioner Angoff, or Director Angoff, in Missouri has a flawed conclusion, based upon analysis of the data that his department supplied him.

Senator BRYAN. Ms. Schubert, you represent an industry group. Did I understand that you also are testifying on behalf of the Big I today? I thought I heard you say that, looking at my notes here.

Ms. SCHUBERT. That is correct.

Senator BRYAN. And obviously, you believe that there is a problem out there; and you support, I believe you said it was, 1188 in the House, which is Congresswoman Collins' bill. Am I right on that?

Ms. SCHUBERT. You are right on the fact that we support 1188. Whether we agree that there is a problem or not, is really a different question.

Senator BRYAN. Well, I would ask you directly: Do you think there is a problem out there?

Ms. SCHUBERT. We do not believe there is a problem in the availability of insurance in urban areas. We have a study that shows 98 percent of homeowners in core urban areas have homeowners' insurance.

However, even if that is absolutely accurate, that is 2 percent of the homeowners that there might be a problem with; and we think that we should address that.

We want data collection, because we want the evidence to be clear, whether or not the insurance is available. There are always going to be neighborhoods that have increased risk or higher risk. That is one of the reasons that we support partnerships with groups like ACORN.

We are working with ACORN, and a number of our companies are working with ACORN, on their Neighborhood Home and Safety Program, to try and reduce the risk in neighborhoods so that we can increase the availability and reduce the cost of insurance.

So, we recognize that there are things that need to be done. We do not think that there is a pervasive discrimination problem, or a lack of availability of insurance.

If I could just, very briefly, very briefly, touch on the Missouri study—there is no conclusion yet by Director Angoff as to whether or not redlining exists. I testified in Missouri with the director on this issue; and his conclusion at that point was, they had not finished their study. What they released was a lot of data to the press, and that data has since been quoted over and over again; but the department has not published any conclusions.

What Director Angoff said at that time was, they had not decided that there was any illegal activity or any redlining. There are some actuarial reasons for the numbers that you are hearing; and I know the people that know me, and are here with me in the back, are thinking, "Oh Lord, please do not let her try and explain it." I am not an actuary, and I cannot do that very well for you today. It has to do with costs per thousand dollars of premium and losses as a percentage of the coverage.

But we do have some people that could put something in writing for you; and I would be more than happy to give you some information in writing on that issue.

[At the time of printing the information referred to was not available.]

Senator BRYAN. Assuming for the sake of argument that you are correct that the Commissioner in Missouri has not reached a con-

clusion—and I do not know whether or not he has—but what about the interpretive analysis that Mr. Bhargava has shared with us? The essence of which is that, look, it is not risk; it appears to be race.

At least, in the instance which he suggests, low-income whites, low-income minorities. Less risk in the low-income minority community, higher risk in the low-income white community; and yet the premiums, according to his interpretive analysis, are higher in the minority community.

Do you find such data in the Missouri study?

Ms. SCHUBERT. That is not what the data says. It has to do with cost per thousand. It is not an absolute premium. It has to do with the cost per thousand, and the risk comparison on cost per thousand of the policy.

I have not looked at the data recently enough to address that today. My memory is that we looked at the actual data, and the conclusion that was stated in the press is not what the data itself shows.

I would be happy to follow up on that.

Senator BRYAN. We will give you an opportunity to respond to that. In effect, I believe you say you are reading the data differently than Mr. Bhargava does. That would be the essence of your testimony?

Ms. SCHUBERT. I think that is true. And the bottom line is: If, in fact, it is based on race, if somebody has data that shows it is based on race, then there is a statute in Missouri, there is a statute in Texas, there are statutes in a lot of States that take care of that; and they should be out there, doing something about it.

Senator BRYAN. Mr. Bhargava's point, I think, in his testimony, is that the NAIC has done a very poor job on—and I am not quoting him exactly, but that is the essence of his testimony, if I recall—that they have done a terrible job in enforcing antiredlining provisions that may exist.

I take it you might reach a different conclusion.

Ms. SCHUBERT. Well, the NAIC is not a regulatory body. It is up to each State's regulators and attorney generals to enforce their State laws and get out there and do something about it.

And I think Mr. Bhargava is correct that there has been a great increase in activity in the States in the last couple of years on this issue.

Senator BRYAN. Ms. Griffin, do you agree that risk is a valid underwriting criteria?

Ms. GRIFFIN. I think you have to look at the type of risk you are talking about. But, yes. I think this discussion, more clearly than anything else, points out the need for data.

There are very many reasons, underlying facts, underlying things that come into the equation, that need to be discussed; and many reasonable minds can disagree on what data presents. But we cannot even get to this level of discussion without the data.

And I would really like to note, on the Missouri study, it at least gets us to the level of losses. And then we can just start discussing. But without information about the losses, how can we even enter into a good discussion about this? I think this is precisely the point.

I have not seen the Minnesota study; but from what Mr. Bell said, I was struck by the fact that they said that they found that the companies had complied with all applicable statutes. And I think that is key.

I think we would have to take a look at the statutes, because many States have statutes which do not protect; and do not specifically prohibit discrimination based on race, and other factors that have absolutely nothing to do with risk. And, in the past, they have not been very strong in enforcing their antidiscrimination laws. This is a very new wave. There have only been a couple of instances of enforcement.

And I think the pressure that the Federal Government is bringing to bear on the State regulators has a lot to do with it; consumer groups, civil rights groups, the litigation. But we are really not going to get anywhere, until we get a little sunshine in here.

Senator BRYAN. And the Missouri study was done, based upon ZIP code, if I understand. You favor census tract data, or at least I think Mr. Hunter testified——

Ms. GRIFFIN. I would like to clarify that. The companies would be reporting only on a ZIP-plus-four, a 9-digit ZIP code, which they have collected, or they issue policies on that basis now.

And then, whoever the data collector for the Federal Government would be, would translate that data into census tract in terms of releasing it to the public; so we could have the benefit of the demographics, like in the banking situation, with HMDA.

Senator BRYAN. Let me press you on that. I am certainly not knowledgeable. I do have a little understanding of census tract data, but in a different context.

The census tract data is a much smaller breakout than an entire ZIP code, would you not agree?

Ms. GRIFFIN. Yes.

Senator BRYAN. And, if I understand what you are telling me—and I will give Ms. Schubert and Mr. Bell a chance, or Mr. Bhargava, to offer comments on that—you are saying that, as you understand the requirement, that the company would be required to base its reporting data on the ZIP code. And that, once that is provided, then it would be broken down into census tract?

Ms. GRIFFIN. That is ZIP-plus-four, the 9-digit ZIP code.

Senator BRYAN. Tell me what ZIP-plus-four is. Mr. Marvin and I have not had a conversation about what ZIP-plus-four means. Tell me what that is. And I do not mean to make light of this, but it will be helpful for me to understand your position.

Ms. GRIFFIN. A while ago, the Post Office in an effort to become more efficient and, I guess——

Senator BRYAN. That is very tempting. No one is going to respond to that.

Ms. GRIFFIN. They went to a 9-digit ZIP code; and 9-digit ZIP codes, basically, break ZIP codes down into, apparently, one-block areas, very small areas. There are computer programs that can convert that ZIP-plus-four data into census tract, with a fairly high degree of accuracy.

So, we have all along been suggesting that as a way to get around the obvious problems that companies would have in collecting census tract. Because when you do census tract directly, you

have to input the addresses as opposed to just numbers with ZIP-plus-four.

Senator BRYAN. So, ZIP-plus-four is what you want; and that, thereafter, it would be broken further down by census tract?

Ms. GRIFFIN. Well actually, it goes up. It is actually ZIP-plus-four, and you are moving up to census tract. But you cannot move down from 5-digit ZIP code to census tract. That is the problem.

Senator BRYAN. Ms. Schubert, what is the problem with that?

Ms. SCHUBERT. Well, unlike what Ms. Griffin just said, companies do not issue policies based upon ZIP-plus-four. Absolutely, unequivocally, they do not issue policies based on ZIP-plus-four; they do not collect that information.

Perhaps Mr. Bell can get into, maybe, some of his companies. The only ZIP-plus-four information that AIA members have is in their mailing computer system, which sends out the bills; and that is it, as far as we can tell. And we have spent countless—of incredibly boring—hours with data collecting people, telling us why this is a difficult task.

But they collect ZIP-plus-four just to send out the bills. And the bill does not necessarily go to where the home happens to be; it goes to wherever the policyholder is. That information is not kept in the policy system; it is not kept in the loss system; and it is unavailable.

On the other hand, if you had a 5-digit ZIP code, although you cannot break it down into census tracts, there is demographic information provided by the Census Bureau which is built up from census tracts to the ZIP code level. In that fashion you can get demographic information on the ZIP code.

Our position is: There is no reason to spend the additional money to change everyone's computer systems, when you can look at a 5-digit ZIP code and you can compare. Say you have 100 policies and you have 102 homes in that neighborhood. You know you do not have a problem.

If you have 100 policies, and you have 300 homes in that ZIP code, then you know that is a ZIP code that you need to take a closer look at. And that is where you should be spending your money.

Ms. GRIFFIN. Can I just respond to that?

Senator BRYAN. Sure, and then we will hear from Mr. Bell and Mr. Bhargava. Go ahead.

Ms. GRIFFIN. Very quickly, and I do not want to get into the specifics, but it is very hard—and I think it is intuitively understandable that it is very hard—to go from ZIP code down to census tract. And census tracts represent different types of neighborhoods.

You do not pick up those differences with ZIP codes. We have run maps on this.

And also, Ms. Schubert talked about a problem with availability when she talked about 100 versus 300 policies. Availability is only one part of the problem. There is also affordability and quality; and it is more difficult to get to those issues.

Senator BRYAN. Mr. Bhargava, let me ask you about the Minnesota study, which Mr. Bell referenced. Are you familiar with that study at all?

Mr. BHARGAVA. I have not read that study.

Senator BRYAN. Maybe, if you would be so kind as to look at it, and share with us your response, as to whether you agree?

Mr. BHARGAVA. I would just make one quick observation on that study; which is that on a ZIP code basis, there is not a single predominantly minority ZIP code in the State of Minnesota—in other words, a ZIP code that has a minority population of more than 50 percent.

So, that the ZIP code data that they worked off in Minnesota was very difficult, to say the least; and it is not a State with a high proportion of minorities.

But I will get back to you, with a more detailed answer.

Senator BRYAN. Let me thank each of you for sharing your thoughts with us this afternoon.

We will give you an opportunity, Mr. Bell. I did not want to cut you off, if you have something else you want to add; to give you the last word here.

And we will keep this hearing record open for a while, for any additional questions.

Mr. BELL. This is a privilege I never get at home. I will make the effort to send a copy of the Minnesota study to each of the panelists and to you, Mr. Chairman, so that you will all have that for your analysis.

The Minnesota study was not based on ZIP code. They simply looked at 4,000 cancellations, wherever they were. And we agree with Ms. Schubert's comments regarding the ZIP-plus-four. Each of us in this room has a ZIP-plus-four. I do not know mine; most of us probably do not know ours, but we each have one.

It is very difficult to collect it, because your applicant does not know what it is.

Senator BRYAN. We appreciate your comments. Thank you so much for joining us.

And this subcommittee will stand adjourned.

[Whereupon, at 5:20 p.m., the hearing was adjourned.]

APPENDIX

QUESTIONS ASKED BY SENATOR BURNS AND ANSWERS THERETO BY MS. GRIFFIN

Question. Ms. Griffin, the proposals before Congress would require insurance companies to collect extensive data. Isn't data on this subject already being collected by the National Association of Insurance Commissioners to be made available by the end of this month?

Answer. While some states have been collecting data related to insurance redlining, state data collection efforts are insufficient. First, the data the National Association of Insurance Commissioners (NAIC) is collecting will be aggregated. It is the understanding that individual company data will not be available unless an individual state agrees to release their data. Without individual company data, it will be difficult to assess the problems in the market and the data will be virtually useless for civil rights enforcement purposes.

Second, only 23 states are participating in this one-time data call and NAIC has no authority to require other states to participate. Third, while the information was collected in May, the NAIC specifically denied requests that it release the "raw data" to the public. It will provide its report and analysis on the aggregated data sometime near the end of the year. The NAIC concluded that it was up to the states to distribute the data or direct the NAIC to distribute the data if requested. Only a few states, however, agreed to release the data upon request.

And finally, under the proposed federal bills, the data would be collected on an ongoing basis and would be accessible to the public from the federal government. And because the data to be disclosed under the bills is already collected by insurance companies, the bills present little, if any, burden on companies.

Question. If this in fact is the case, why do you feel the federal government needs to get involved in an issue that the state has jurisdiction over?

Answer. While states have had primary responsibility over the regulation of insurance, it is important for the federal government to get involved in this issue. Communities devastated by the effects of insurance discrimination should be the concern of the entire country. Redlining of neighborhoods and discrimination against individuals by the insurance industry presents a heavy drain on the nation's economy, destroying jobs and economic development and sapping badly needed tax revenues. It is in everyone's interest, from the lowest income consumer to the most affluent, to end these destructive and immoral practices.

The federal government should collect and disseminate data on the insurance market for a number of reasons:

- Numerous studies in various markets throughout the country indicate that insurance may not be available to poor and minority consumers when it would be available to nonminority consumers in similar circumstances.
- The insurance industry operates in a national market in which some of the largest companies operate in most of the metropolitan areas of the country and there is currently insufficient information available on a nationwide basis to measure the extent of discriminatory practices within the insurance industry.
- A centralized data bank is the most efficient and effective way to measure the extent of redlining and discrimination throughout the country and within firms that participate in interstate commerce.
- Data would be useful to federal agencies responsible for enforcing certain laws. Both the Assistant Attorney General for Civil Rights and HUD's Assistant Secretary for Fair Housing testified before the Senate recently about the need for the information. For example, the Department of Housing and Urban Development is charged with enforcing the Federal Fair Housing Act. If there is discrimination in homeowners insurance or a problem with access and affordability, this agency should have this information to determine whether and what kind of action is needed.

Question. Do you believe that the states are not doing their job as it relates to redlining and that the way in which you resolve the problem is to create another federal agency?

Answer. With few exceptions, states have not taken any actions against companies in the area of race-based or unfair discrimination, discriminatory marketing and distribution systems, or they have not vigorously advocated for the tools to address this problem. The few actions taken in recent years have been taken by "pro-consumer" commissioners who serve terms. Their replacements may not be so pro-active. If data from the federal data base reveals problems, it will be easier for the federal government and the broad range of interested groups who will have access to the data to ask regulators to take action to address the problems. None of the bills currently before Congress would create another federal agency.

- The federal government has historically been active in enforcing civil rights laws, often because of the failure of states to act in this area.
- Many state insurance departments, particularly in states with lower populations, lack the resources and expertise to collect and analyze data relating to insurance discrimination.

Question. Do you have any cost estimates as to what it will take to oversee the activities that are described in the legislation? Congress is operating on a tight budget and I want to make sure that before we commit to something, no matter how big or small, we can pay for it! Before you answer this question, I think it is important for you to know that Congress had to pass a supplemental appropriation of $200 million to hire 100 plus lawyers to implement the Cable Re-Regulation bill that Congress passed last year. No small potatoes as far as this Senator is concerned.

Answer. According to the cost estimates released by the Congressional Budget Office and contained in the Committee Reports, the cost for data collection under the bills ranges from approximately $1 to $16 depending upon which bill and which year the cost estimate is associated. These estimates include early years and do not appear to be based on continuous reporting after the first few years, which may be less because of one-time only start up costs.

QUESTION ASKED BY SENATOR BURNS AND ANSWER THERETO BY MR. BELL, NAII

Question. Would you describe the constructive actions NAII and others in the industry are taking to address the issue of availability and affordability of property and casualty insurance in urban and rural areas?

Answer. The NAII Board of Governors appointed a board level Urban Issues Task Force in the Spring of 1994 to thoroughly analyze the full scope of urban insurance issues and to present specific policy recommendations and action steps which may relieve tensions and achieve positive results regarding both insurance availability and affordability. While the work of this Task Force and its four special subcommittees is still in process, we can already identify a few of the areas of study: liaison and support for community "rebuilder" groups such as Neighborhood Housing Services and other similar organizations; consideration of establishment of insurance Market Assistance Programs where accessibility to available insurer markets is not understood by residents; possible modifications to the insurance product offerings of the FAIR Plans where appropriate; incentives for broader voluntary market participation such as premium tax credits for insurers, take-out and keep-out credits for insurers against FAIR Plan assessments; efforts to promote greater loss prevention efforts by urban/rural dwellers (i.e. anti-crime, anti-fire); and exploration as to viability of the concept of group insurance pricing for urban residents who are members of identified established community groups.

NAII member insurers and others currently insure millions of homes, families and businesses in urban areas across the United States. Bach insurer has its own underwriting guidelines and many urban properties fall within their parameters. Studies indicate that 96 percent of the homeowners in the United States, including those in urban areas, currently carry homeowners insurance.

Essential property insurance is available in about thirty states through property insurance residual market mechanisms of last resort generally known as FAIR Plans. These insurance industry supported plans make insurance available to urban, and in some instances rural, residents. All property insurance companies participate in these plans which make coverage available for structures which would otherwise be uninsurable.

Many NAII member insurers and others work with the National Housing Service, Urban Leagues and other groups which are genuinely concerned with improving living conditions, instilling neighborhood pride, mitigating the causes of loss, improving living conditions, and enhancing the insurability of homes in urban areas. NAII and its member insurers also works with these organizations to foster better under-

standing of urban risks by insurance underwriters and a better understanding of the insurance process by consumers. Such joint activities include:

- Bus tours through urban areas to allow underwriters to see individual risks first hand.
- Monetary contributions to NHS.
- Insurance company employee participation in voluntary programs to build/rebuild inner-city neighborhoods.
- Educational programs to increase consumer awareness about insurance availability.

NAII member insurers and others cooperate with state regulators and the National Association of Insurance Commissioners (NAIC) to provide statistical data, which when analyzed will assist in supplanting conjecture with fact regarding the true nature of urban insurance availability. Insurers, regulators and others can thereafter determine the appropriate market based response to any statistical revelations.

NAII member insurers and others held a prospective insurance agent job fair in Chicago in 1992 in order to expose urban residents to the insurance agent career possibility.

NAII member insurers and others sponsor and financially underwrite the Illinois Insurance Hotline, which has given free insurance information to over 45,000 Illinois residents since 1990. A similar program in operation is known as the Milwaukee Community Insurance Information Center.

NAII member insurers and others participate in the Illinois Insurance Department's Urban Issues Task Force. One current project is to train counselors to assist urban residents with prepurchase counseling.

NAII member insurers and others financially underwrite and support the mission of the Insurance Institute for Property Loss Reduction in its loss mitigation role. The Institute is currently working with the roofing manufacturing industry to design standards for less damageable roofing from loss by wind, hail and fire. The Institute is also working with the three national building code organizations to achieve greater uniformity and to strengthen national standards which will reduce future insured loss. The Institute is also assisting states and local communities to adopt retrofit codes which can be applied to existing structures in order to reduce to severity of insured loss.

NAII member insurers and others financially underwrite and support the mission of the Insurance Committee for Arson Control (ICAC). ICAC seeks ways to reduce the incidence of the unconscionable act of deliberately setting a fire. Arson caused over $2 billion in property loss and 605 lives lost in 1992 alone. ICAC works with public and private sectors, legislators and regulators, individuals and groups to seek out solutions and to take steps that will make a difference.

NAII member insurers and others participate in the Hawaii Hurricane Relief Fund and the Florida Hurricane Catastrophe Fund. These funds were created as risk spreading mechanisms so that insurers could continue to provide their products and services to all residents of those states, both urban and rural.

NAII member insurers and others, working through the Natural Disaster Coalition, envisioned and drafted the framework of the Natural Disaster Protection Act. Lead sponsors are Senator Daniel Inouye, S. 1350, and Representative Norman Mineta, H.R. 2873. The Act will provide a means whereby all Americans will be able to purchase catastrophe insurance at actuarially sound but reasonable prices.

NAII member insurers and others have invested heavily in municipal bonds which provide for needed public facilities and services and infrastructure repair. This make urban communities better places to live and work and better places for insurers to make their products and services readily available.

There are many contributing factors to rising automobile insurance premiums. The NAII believes the problem of affordability must be attacked on a number of fronts and on a state-by-state basis. The magnitude of the affordability problem, the demographics of the state, and the prevailing political conditions are among the considerations in an valuation as to which of the following issues is action warranted: reformation of insurance coverage and state auto insurance laws, medical cost containment, safety oriented automobile design/repair and insurance rating, strengthening of the traffic laws and motor vehicle code, improved anti-theft countermeasures, steps to reduce insurance fraud, anti alcohol and drug deterrence and enforcement, civil justice reform, and reduced automobile usage. Each of these issues and the state action steps advocated by NAII are contained in the enclosed monograph titled Containing Auto Insurance Costs.

Insurance fraud is a serious crime that drives up the cost of insurance for everyone. The insurance industry seeks to join forces with the public, legislators and the law enforcement community in a renewed effort to attack and deter insurance fraud.

The enclosed NAII monograph titled Antifraud Task Force Report & Recommendations contains specific recommendations to be undertaken in order to deter insurance fraud.

NAII seeks to repeal compulsory auto liability insurance laws. In concept compulsory is sound, but in practice its a failure, e.g., liability insurance is unnecessary coverage for poor motorists and operates like a regressive tax. NAII supports a low cost, no-frills policy (Maxi-Value Policy) it conceived in states where affordability problems are acute.

[Referenced material above may be found in the committee file.]

QUESTION ASKED BY SENATOR BURNS AND ANSWER THERETO BY MR. BHARGAVA

Question. Mr. Bhargava, we take risks every single day! In fact, in this town, you take them the moment you step out the door. Insurance is like every other business, you take risks! In fact, I would argue huge risks! It is a business in the sense you have a product to sell to someone who is able to pay for it. In any business, that product will cost more or less depending on location, the cost of materials, labor, transportation and so on. What cost $5 in Washington, D.C. might only cost $2.50 in Billings, Montana. The point I am trying to make is that there are a number of factors that go into any business decision. In the case of insurance, it bases prices on the assessment of risk. Do you object to basing the price of insurance on risk assessment? If you believe risk-based premiums are wrong, do you have another solution?

Answer. I believe that in the case of property insurance for homes, autos, and small businesses, it is appropriate to base the price of insurance on the basis of risk. There are, however, several corollary questions which this issue raises.

First, is it appropriate to rely for the most part on geographically-based assessments of risk, or individually-based assessments of risk for the purposes of underwriting and pricing?

Under the present system, it is likely that a good driver living in an urban area, but commuting to the suburbs for work, will pay significantly more in premiums than a driver with a poor record residing in a suburban area who commutes into the city for work. This is clearly a perverse consequence of a geographically-based system for arriving at insurance prices.

ACORN believes that while it may be appropriate for insurance underwriting practices to rely in part on geographical assessments of risk, the current system exaggerates this aspect of risk experience to the neglect of factors focusing on an individual's risk.

Second, do the industry's pricing policies accurately reflect risk?

A recent study by the Missouri Department of Insurance suggests the opposite. In its analysis of zip-code based data, the Department found that residents of low-income, predominantly minority neighborhoods pay more per thousand dollars of coverage than do residents of low-income, white neighborhoods in St. Louis and Kansas City. However, the study found that residents in low-income, minority areas actually incurred fewer losses. This suggests that the pricing policies of insurance companies may reflect factors other than risk, which may include racial bias or stereotypes. That is precisely why comprehensive disclosure legislation along the lines proposed by Senator Feingold (D-WI) is so urgently needed.

Third, if there are disparities in the price of insurance in different neighborhoods that accurately reflect risk, what is the appropriate public policy response?

Even if the industry is correct in its contention that price differences between neighborhoods of different racial and income compositions are justified by risk experience (we can't verify this claim without access to data), large price disparities may still be a matter of concern.

To the extent that small businesses, for example, in minority areas are made uncompetitive by virtue of high premiums, job creation in distressed areas will suffer. To the extent that homeowners policies or auto policies are priced beyond the reach of many residents of low-income areas, homeownership rates and mobility will suffer.

So, whether the ultimate cause of price disparities is risk or prejudice (or a mixture of the two), the public has a compelling interest in access to comprehensive data on property insurers' policy writing and loss data.

QUESTIONS ASKED BY SENATOR BURNS AND ANSWERS THERETO BY MR. HUNTER

Question. What efforts have you made as Commissioner to alleviate the problem of redlining?

Answer. Our regulatory philosophy is to rely on market forces to provide the necessary insurance to consumers at the lowest prices. In the case of certain lines of insurance—property insurance, automobile insurance, business liability insurance—availability is unfairly restricted because of geographic location. The lack of availability represents a market failure and we have initiated several activities to address these market failure and improve the competitive operation of insurance markets.

First, we have made a significant investment in improved information to both consumers and producers of insurance. Our independent data initiative in Texas represents the most far-reaching state program to wrest control of insurance data collection from the insurance industry. The result of independent data will be more reliable, more detailed and more timely data for insurers to use in making their business decisions about pricing of insurance. In addition, we have provided insurance consumers with information about buying insurance, including tips for insurance shopping and a consumer's bill of rights for auto and homeowners insurance. We provide price comparisons for homeowners and auto insurance and are working with vendors to provide an electronic pricing service for consumers.

Second, we have passed and enforced rules which prohibit unfair discrimination in the sale of insurance. We believe that underwriting guidelines and rating factors—the characteristics of the consumer, vehicle or property—which determine whether an insurer will sell insurance and at what price should be substantially related to risk of loss or size of administrative expense. We have passed rules which prohibit the use of underwriting guidelines which are arbitrary and not related to risk of loss. Allstate paid a fine of $850,000 after we challenged them on unfair underwriting guidelines and we have cases pending against dozens of other insurers for illegal and unfair underwriting guidelines. For a competitive market to operate successfully, the Department of Insurance must use its regulatory powers to eliminate unfair trade practices which put consumers or law-abiding insurers at a competitive disadvantage.

Finally, we understand that even in a competitive market, financial incentives may be necessary to bring more producers into the market. In the case of mandatory auto liability insurance, we have found a striking availability problems in many parts of Texas with a high minority populations and/or low household income. While we are working to ensure that insurance companies are not unfairly discriminating against people living in these ZIP Codes, we are also working to provide incentives to insurers for voluntarily writing business in these ZIP Codes. Specifically, insurers will receive a credit against their quota from automobile assigned risks for each vehicle voluntarily written in those ZIP Codes designed as underserved.

Question. What efforts have been made by the National Association of Insurance Commissioners?

Answer. The NAIC has established an Insurance Availability and Affordability Task Force to examine the issues of redlining. The Task Force, with the support of NAIC staff, has established a program to study the issue. To date, the NAIC Task Force has performed a literature review, analyzed studies produced by other sources, collected some ZIP Code data from insurers and looked at some non-quantitative tools for analyzing availability and affordability problems. The Task Force is still in the study stage and will be in the study stage through next year.

Question. Does the federal government need to get involved? Are we moving away from state-based regulation and to wards federal government takeover?

Answer. The federal involvement anticipated in S. 1989 is limited, relevant, and appropriate. S. 1989 is limited to the collection of data only. It assures a uniform national database which would allow a broad and thorough statistical analysis of insurance availability and affordability. In comparison with the 22 states included in the premium only zip code survey of the NAIC, this database would better focus efforts to address the real problems of redlining. S. 1989 would enhance state-based insurance regulation by making better data available to regulators for their analysis and use.

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