Testimony of Nathaniel S. Shapo

House Committee on Financial Services

Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises

Honorable Richard H. Baker, Chairman

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COMPETITION AND EFFECTIVE REGULATION OF INSURANCE RATES

Introduction

Mr. Chairman and members of the committee, thank you for the opportunity to appear before you again as you conduct your important oversight work.

My name is Nat Shapo. I am a partner at Sonnenschein Nath & Rosenthal LLP and I am a Lecturer in Law at the University of Chicago Law School.

I had the privilege of serving as the Illinois Director of Insurance from January 1999 to January 2003. During that time, I was elected four times to the National Association of Insurance Commissioners Executive Committee, including twice as a national officer.

I have previously served as a witness in front of this committee regarding government price controls, which is the topic of my testimony today. During my time as a regulator and since, I have firmly believed, and argued, that competition, not government, is the most effective regulator of personal lines automobile and homeowners insurance rates.

The solvency regulation, market conduct oversight, form review, and responses to consumer complaints carried out by the professional and dedicated members of state insurance departments throughout the United States are all necessary and appropriate functions of government. Without this affirmative state oversight, the insurance market would be subject to a race to the bottom and policyholders would be in substantial peril.

But consumers comparison shop based on price every day for purchases large and small. They are perfectly able to use the law of supply and demand to protect themselves regarding the proper amount they should be charged for a good or service. Competition is the most aggressive regulator of prices that the economy has ever known.

I believe it is entirely appropriate for Congress, in its Constitutional role as the regulator of interstate commerce, to consider updating its laws to properly reflect the needs of consumers in today’s insurance marketplace. Congress’s previous policy choice in the McCarran-Ferguson Act to encourage the states to engage in anti-competitive regulatory practices in order to support solvency regulation has been made obsolete by advances in sophisticated financial regulation and by the development of a thriving competitive marketplace for personal lines insurance.

History, experience, common sense, and basic economics all suggest that Congressional action to install a regulatory system relying on the law of supply and demand rather than price controls is an appropriate oversight measure commensurate with consumer need in today's highly competitive personal lines insurance marketplace. Since Congress was largely responsible for today's price controls, it can preempt state laws in this area of oversight without disturbing the current balance of federalism or jeopardizing the primacy of state regulation in any way.

A Peculiar, Unique, and Upside Down World

At this point I'd like to ask you to consider the following hypothetical. A committee or subcommittee of Congress has oversight of an industry through its Constitutional authority over interstate commerce.

Suppose that industry has the following characteristics. Hundreds of sellers offer the product in question to consumers who are fully able to comparison shop for price. The market is not concentrated or monopolistic. In fact, sellers aggressively and directly claim that they can beat their competitors' prices. Advertising is ubiquitous: television, radio, print, internet, billboards, direct mail, etc. The product is accessible to consumers and can be purchased through a variety of means: over the phone, in person, or over the internet; directly from the company or through a trained agent. Comparison of price is feasible since the product sold is relatively common and standardized.

If you would further suppose that I came and argued to the relevant oversight committee that the product in question should be subject to government price controls; that the form of those price controls should require sellers to submit their proposed prices, in advance, to a regulatory agency with substantial documentation; and that the agency might perform a time-consuming review of these submissions before deciding whether the seller's prices could be used in commerce.

I expect that if I provided such testimony, I would be given a lecture about free markets by members from both parties, and told that I had a complete misunderstanding of basic, consensus ideas about American public policy. I also suspect that I would never be invited back and that whatever staff person was found to be responsible for suggesting or approving my participation would soon be joining me out in the street.

For some reason, however, because the product in question is insurance, when I express the opposite view -- that government price controls in a competitive market should be done away with -- this is not treated as a thoroughly self-evident, non-controversial premise, but is rather seen as a suggestion that will surely face an enormous battle to be codified.

The History of Price Controls in Insurance: Rate Regulation as a Solvency Tool

What makes insurance different than any other product? Why is it not obvious that price levels in a competitive marketplace should be regulated by supply and demand, as they are throughout the economy without exception? An unusual history explains how we got here. But, in studying that history, it is clear that there is no reasonable rationale for the common practice of seeking to ensure affordability and availability of auto and home insurance through price controls.

Rate regulation in insurance has its roots as a solvency tool. In the 1800s and early 1900s, repeated catastrophic events in the primary line of coverage used by average Americans -- fire insurance -- were the catalyst for an unusual regulatory response. All too frequently, urban conflagrations, such as the great Chicago fire and the San Francisco earthquake and fire, led to mass carrier insolvencies.

Policymakers studying the problem found that competition led to harmful results in the insurance business. Both underwriting and solvency practices were unsophisticated and crude. Reserving standards were terribly inadequate. Cutthroat price wars and the struggle for premium only exacerbated the problem. So, in the early 1900s, just as trust-busting was becoming the order of the day, and competition was embraced as the most effective way to ensure affordability of product and protect consumers, insurance regulation began pursuing an opposite course, as legislators sought to restrict competition in insurance rate-making.

In order to avoid under-pricing and the disastrous insolvencies which followed, states passed laws which encouraged carriers to collude with each other and even make rates in concert. Because government was encouraging monopolistic behavior, it had to regulate the resulting rates to prevent the abuses which can occur when there is no competition. Rate regulation also allowed government to ensure that collusion was producing the desired result of prices which were adequate to support solvency.

It is essential to understand that rate regulation was a means to the end of keeping prices up in order to support carrier solvency. The purpose of rate regulation was not to ensure affordability and availability of insurance coverage for consumers.

The underlying premise that justified this entire system was that rate regulation was appropriate in a non-competitive market. The Supreme Court, in narrowly upholding an early state price control law as constitutional, explicitly referenced the lack of competition in the marketplace as a justification for the statute in question.

> We may venture to observe that the price of insurance is not fixed over the counters of the companies by what Adam Smith calls the higgling of the market, but formed in the councils of the underwriters, promulgated in schedules of practically controlling constancy which the applicant for insurance is powerless to oppose and which, therefore, has led to the assertion that the business of insurance is of monopolistic character and that "it is illusory to speak of a liberty of contract."

German Alliance Insurance Co. v. Lewis, 223 U.S. 389, 416-17 (1914).

Thus, the intellectual and legal underpinnings of government rate regulation of the business of insurance are rooted in a market that was recognized as uncompetitive and "of monopolistic character." These traits were essential to justifying the rationale for price controls.

The McCarran-Ferguson Act: Disabling Competition Was the Choice in 1945

The practice of rate regulation was somewhat common but far from uniform in the states by 1944, when the Supreme Court declared in the Southeastern Underwriters case that insurance is interstate commerce. This case dealt with an indictment for violations of the Sherman Act, which a cartel of carriers had brazenly violated because they believed that this federal law did not apply to insurance, since the business had previously been held by the Supreme Court not to be interstate commerce.

In the Southeastern Underwriters case, the Supreme Court specifically recognized that opponents of the decision had forecast doom for insurance carriers and consumers if competition was unleashed on the industry. But the Court held that competition was a fundamental tenet of regulation of commerce under American public policy, which "make[s] of ours, so far as Congress could under our dual system, a competitive business economy." U.S. v. South-Eastern Underwriters Assn., 322 U.S. 533, 559 (1944). The Court acknowledged "opinions expressed by various persons that unrestricted competition in insurance results in financial chaos and public injury," but concluded that only a conscious choice by Congress could exempt an industry from such regulation: "Whether competition is a good thing for the insurance business is not for us to consider." Id. at 561.

The next year, in response to the Supreme Court, Congress did decide that competition is not "a good thing for the insurance business." The landmark McCarran-Ferguson Act of 1945 essentially established a national policy favoring price controls for the industry. McCarran-Ferguson and the subsequent "All Industry" bills, which quickly and broadly passed in the states based on NAIC models, were a swift reaction to, and codification of, the prevalent argument at the time: that competition in the insurance business was bad for consumers and thus must be disabled.

McCarran-Ferguson was intended to prod the states to replace the inconsistent patchwork of rate oversight with thorough price controls in all states. As Senator O'Mahoney, a conferee on the final bill, explained:

> The conference report would give to the States, to the Congress, and to industry the opportunity to adjust the laws and insurance practices as to bring clarity into the whole situation, in the public interest. It is an invitation to the States to legislate in good faith. It is an invitation to the insurance industry to operate in good faith in the halls of the various State legislatures, and of Congress.

91 Cong. Rec. 1486-87 (Feb. 27, 1945).

The purpose of these rate regulatory laws was to serve as a crude means of solvency regulation, not a method of ensuring availability and affordability. It was then (and of course it remains) bedrock American public policy that competition, not government micro-management, is the best way of ensuring availability and affordability and protecting consumers.

At the time, stifling competition, though a highly unorthodox approach to regulation of commerce, was appropriate consumer protection due to the unique concerns about under-pricing and bankruptcy in the insurance business. There is no more important consumer protection than ensuring that policyholders’ claims will be paid by regulating carrier solvency. (This was particularly true in an era when there was no guaranty fund coverage.) Price controls were thus used for their proper purpose: preventing abuses when government sanctions monopolistic practices.

Since government had decided that price wars were harmful to consumers, and had intentionally disabled competition in the insurance marketplace, it needed to institute rate regulation. It was never suggested, however, that price controls were appropriate for a competitive industry, or that price controls are an effective means of making a product affordable and available.

The Market Has Been Transformed by Competition Since McCarran-Ferguson

The McCarran-Ferguson Act had the effect on the insurance market that Congress intended. By providing that the antitrust laws would be preempted should the states occupy the field with rate regulation, Congress incentivized the states to enable and regulate collusive practices.

In the years following McCarran-Ferguson, competition was stifled. States uniformly passed the All-Industry laws, under which state insurance departments reviewed prices in advance to ensure that rates were not inadequate, excessive, or unfairly discriminatory. Rating bureaus ruled. Prices were made in concert by cartels in every state.

The market, however, began to transform in the 1960s. Independent carriers, which developed their rates outside of the bureau system, appeared -- and thrived. In the following decades, personal auto and homeowners have become intensively competitive markets. This is evident to the most casual observer today.

For instance, as I watched my Illinois Fighting Illini wear their orange uniforms all the way to the national title game on their "Road to the Final Four" this spring, I was inundated with commercials from at least four of the major national carriers, each claiming to offer a better price than the rest, several of them naming the others by name and giving specific examples of price savings by consumers.

This is interstate commerce. It is the very embodiment of a competitive marketplace. But it is still regulated state by state with a heavy dose of price controls. I believe that this dynamic should be regarded as highly irregular.

Mismatch: Price Controls Are Not an Affordability/Accessibility Tool

The marketplace has matured, but the regulatory system has not with respect to oversight of price. Rate regulation, which was an appropriate tool for solvency regulation at the time of McCarran-Ferguson, has morphed into a means of attempting to ensure availability and affordability of insurance.

Today, states frequently view rate regulation as a necessary tool in keeping insurance affordable for consumers. This represents a total mismatch of ends and means. The end goal of insurance rate regulation, as conceived by policymakers through the passage of the McCarran-Ferguson Act, was not to keep prices from being excessive, it was to keep them being inadequate.

The notion that price controls should not be used to promote affordability and availability in a competitive marketplace is completely uncontroversial. I doubt you could find a credentialed economist to disagree with that generic statement. Yet that is precisely what states routinely attempt today in the insurance marketplace, with disastrous results.

This committee over the years has well documented the problems that price controls have created in the insurance market. Predictably, states which have relied heavily on this tactic have badly choked the supply of insurance. The usual result is that prices are no lower than they would be otherwise, and availability is severely restricted.

Policymakers in New Jersey now acknowledge that years of rate rollbacks and prior approval regulation did not keep rates down. They further bemoaned the affects of these punitive regulatory policies on availability: It became common for well-qualified risks to have to wait weeks and go begging to be taken on by carriers who wanted to reduce rather than grow market share.

In pressing for competition-based reforms, former Governor McGreevey noted that "it's no longer possible to walk into an agency and walk out with a policy." He criticized "the insanity of a system that forces good drivers to wait for weeks, even months, to obtain coverage … when carrier after carrier gives up on New Jersey." Thus, he concluded that "[f]or too long, the auto insurance crisis has been viewed as an affordability issue. Every day we see new evidence that it is no longer just about affordability, it is very much about availability."

New Jersey's experience validates the simple economic truism that government price controls undermine competition by causing supply to wither. Sellers will not fully participate in a market when they fear government capture of their capital. Inadequate capital and supply of a product causes severe availability problems and great consumer harm.

Even California, which has had relatively low rate increases compared to the national average since instituting aggressive price controls under Proposition 103 in 1988, is a poor advertisement for rate regulation. Statistics clearly demonstrate that moderate rates have been caused by an extraordinarily favorable loss climate in California since 1988. The substantial decline in payouts has been fueled by several developments, including a landmark court decision which limited jury awards; strong drunk driving and seatbelt laws; and progressive road construction standards.

In fact, rates in California have not been as low as they should have been given the extraordinary relative decline in loss payments since 1988. Instead, carriers, afraid of government capture of their capital, appear not to have sought rate decreases commensurate with losses and expenses. Instead, they likely hedged against the risk of politically-driven rejections of necessary and justified rate increases in the future. As a result, consumers may not have enjoyed the full reduction in rates that was likely justified by actual and expected losses, and which should have been available to them in a normal, responsive, and well-functioning market.

Price controls are designed to address and mitigate a market defect: monopolistic conditions. As discussed above, when a market is not ruled by, using the Supreme Court’s description, "what

Adam Smith calls the higgling of the market," but is rather "of monopolistic character," government has a proper role regulating in the stead of market forces.

The insurance market, however, has since been transformed by competition, and in competitive markets, price controls create market defects. The results in New Jersey and California -- an availability crisis spurred by diminished supply, and the failure of the market to fully internalize favorable conditions, respectively -- are the unfortunate, but highly predictable, results of what happens when government tries to micro-manage the supply and demand curves which, left to do their work unabated, are so helpful to consumers in free markets.

Thorough Regulation: In Illinois, Government Regulates Only What Competition Cannot

Illinois has achieved great success by regulating rates through competition. I was privileged to serve as the Illinois Director of Insurance for four years, from 1999 to 2003, and I found that the so-called Illinois system works for the benefit of consumers.

The Illinois insurance code does not have the "magic words," dating back to the post-McCarran-Ferguson All-Industry Bills, which empower the insurance commissioner to review rates to ensure that they are not "inadequate, excessive, or unfairly discriminatory." The Director's authority to regulate rate levels disappeared thirty years ago; prohibitions against unfairly discriminatory and/or unfair or deceptive acts or practices remain on the books.

Even though the Director has no authority to review rate levels, rates are surely regulated in Illinois: Instead of government passing on the proper price a seller can pay in a competitive market, personal lines auto and homeowners rates are regulated by the most ruthless force in a capitalist economy, the pressures of supply and demand.

The results are impressive. Illinois has consistently had the most or nearly the most carriers writing auto and home insurance of any state in the country. And prices have been stable and moderate, ranking either in the middle of the state rankings or below average: 27th highest in auto and 39th highest in homeowners in studies conducted during the last decade.

Coverage in Illinois is not just affordable, it is widely available. The assigned risk plans for auto and homeowners insurance in Illinois have traditionally been negligible, far less than 1% of the market. The inability of qualified risks to gain coverage (such as the residual markets approaching or exceeding one-third of all drivers in the heavy rate regulatory environments seen in recent years in states like Massachusetts, New Jersey, and South Carolina) is unheard of in Illinois.

Illinois regulates the insurance marketplace in areas where consumers are in need of government intervention. The average policyholder is not an accountant or an actuary and cannot be expected to understand her carrier's balance sheet, so the state must regulate carrier solvency affirmatively and aggressively. Likewise, most consumers are not contract lawyers and do not understand the ins and outs of their policies, so the states should review and approve forms. And consumers are at an information disadvantage vis a vis carriers regarding claims handling and related behavior, so the states need to regulate market conduct and consumer complaints. Illinois does all this proactively.

But consumers do know how to comparison shop based on price. They do it every day, and every other product they buy that is competitively sold is not subject to price controls. This applies to pleasure goods and necessities alike.

The homes and automobiles that people need insurance for are perhaps the most expensive purchases they make, far more costly and difficult to execute than insurance, and are sold in relatively byzantine markets. The prices of cars and houses, however, are not regulated while the rates of the insurance products which cover those purchases are.

Have the people in the committee room here today found valuing real estate -- which involves, among other things, understanding the value of land, understanding home inspection reports, comparing the benefits and drawbacks of neighborhoods, and trying to gauge the rate of appreciation in the housing market -- easier than pricing an insurance policy? Are consumers more at risk buying auto insurance than they are walking into the car showroom and trying to figure out whether the list price is reasonable and the back and forth between the manager and the sales agent is fair to them? I think the answers to these questions are "no," but the prices of homes and automobiles (and all other non-monopolistic products) are not regulated by government. Why?

These prices are not regulated by government because it is well understood that the best and most efficient regulator of prices for the benefit of consumers is competition. Supply and demand forces sellers to offer goods and services at the proper price -- what consumers are willing to pay with an appropriate profit built in for the seller. Competition keep prices reasonable; it reacts to the marketplace in much more nimble fashion than government can ever hope to; and it ensures that capital, without fear of irrational government capture, flows to markets, producing adequate supply.

It is somewhat misleading to label Illinois with the shorthand moniker of a "deregulated" market. Everything is regulated in Illinois. In areas where consumers cannot fully protect themselves, like solvency regulation and market conduct, government takes proactive steps. But when it comes to prices, where consumers know how to, and can and will, empower themselves, government lets the law of supply and demand regulate the market. By leaving price regulation to the experts -- market forces -- state regulatory agencies can focus their scarce resources on areas where government intervention is necessary to protect consumers.

In Illinois, government's role in overseeing rates is limited to monitoring the market to ensure that the strongest regulator of prices -- competition -- is in place. Illinois law, which does not empower the Director to regulate price levels, does instruct him to prepare an annual report to the legislature analyzing the property-casualty markets and determining whether competition is present. This statute, known as the Cost Containment Act, ensures that consumers are in fact receiving the regulatory benefits of competition, as it will alert policymakers if monopolistic conditions emerge.

The Director's cost containment reports annually demonstrate that there is full and strong competition between sellers of personal auto and homeowners insurance in Illinois. The Herfindahl/Hirschman index calculations used in the Division of Insurance's statistical analysis demonstrate that these markets are not concentrated but rather are highly competitive.

I also note that the Division's calculations demonstrate that the professional liability markets are highly non-competitive, which is why the insurance code has always given the Director authority to regulate these rates for excessiveness and inadequacy.

Illinois presents a solid and well-developed example. The so-called "open competition" system has been in place for over three decades and has during that time enjoyed broad bipartisan support in the General Assembly. The reason for this is simple: it works. In fact, it would be shocking if the system did not work, since it is merely the implementation of time-tested and bedrock ideas about how markets work for the benefit of consumers.

I sometimes find myself cringing, however, when the "Illinois system" is discussed. It is often cited or described, sometimes even by proponents, as a strange, dark, and mysterious being. The implication is that this is some kind of remarkable experiment that somehow, unexplainably, has managed to be successful. Even though it is a bizarre outlier, the argument seems to go, it is worth considering because it has produced good results.

I submit that this is the wrong way to approach the issue. Illinois should not be considered an "experiment" nor should it be regarded as radical. The way Illinois regulates could not be more mainstream. Instead, any system of overseeing commerce which empowers government to regulate price levels in a competitive market is strange. The default rule should be competition, not price controls.

It is not miraculous -- or even notable -- that Illinois has achieved good results by letting competition regulate auto and homeowners insurance rates. Illinois' healthy market is precisely what one would expect, and it is perfectly consistent with prevailing American public policy.

Using price controls as an affordability and availability mechanism, by contrast, is not what one would expect. It only happens in insurance because of this industry's unique history. Price controls were appropriately used as a solvency tool in a system sanctioned and driven by Congress. But price controls have morphed into something for which they were never intended -- much to the detriment of consumers.

Congress's Role Regarding State Price Controls Over Insurance Rates

This is very much Congress's business. The issues I am discussing profoundly impact interstate commerce. One need look no further than New Jersey to understand the national commercial implications of this issue.

As New Jersey passed more and more punitive laws in the late twentieth century, carriers began to bleed more and more red ink from their New Jersey books of business. This diminished the common fund and threatened the well-being of consumers in other states, so companies, who had a responsibility for the well-being of all their policyholders, chose to quarantine the risk from New Jersey by establishing single state companies with separate, New Jersey-only capital. The supply of insurance in New Jersey then dwindled to the point of a crisis as more and more carriers began to limit how much they would write and/or took action to withdraw from the market altogether.

Since New Jersey has begun moving toward a more competitive marketplace, however, the trend has reversed. Carriers which were leaving have tabled those plans, and carriers which had previously refused to do business in New Jersey have decided to enter.

A prominent success story for New Jersey's market-based reforms is GEICO, a leading national writer which had before chosen not to seek business in this very populous state. GEICO has now entered the market, and has done so "whole hog": It has not formed a single state company but rather is doing business through the parent corporation. This decision would never even have been contemplated under New Jersey's old, aggressive rate regulation regime.

New Jersey is an extreme example, but there is significant reason to be broadly concerned that price controls and government capture of capital in some states can affect consumers in other states.

Testimony in prior Subcommittee hearings has also suggested that the property-casualty market on the whole is likely undercapitalized. Fear of government capture of carrier capital prevents investment from fully flowing to the market. Investors react negatively to concerns that rate regulation will prevent sellers from reacting to changes in the market and adjusting their prices -- either up or down -- as appropriate. Supply is therefore not as ample as it should be in a market-based system, resulting in prices no lower than they would be under competition -- and diminished availability of product.

Thus, state rate regulation is certainly a fair topic for Congressional debate and possible action. Not only do state price controls fall squarely within Congress's oversight of interstate commerce, they are very much a result of prior Congressional action. The appearance of state laws which authorize government to regulate price levels for inadequacy and excessiveness did not appear in every state out of the blue; they have largely resulted from a policy choice made by Congress in the McCarran-Ferguson Act.

This committee has received ample testimony in recent years that the market has changed dramatically since 1945. The need to effectively shut down competition receded long ago. But the regulatory tools which were designed to disable competition are still here today, only they are being used to an end for which they were not created.

Nothing could be more appropriate than for the Congressional committee tasked with regulating a particular kind of interstate commerce to examine that market; create a full record which demonstrates that the conditions which spurred a previous and unique Congressional policy choice are no longer present; and to adapt policies which are consistent with the marketplace which exists today, thus bringing an outlier industry into line with prevailing American public policy favoring regulation of competitive markets by supply and demand.

This is proper and necessary oversight. The presumption in favor of competition throughout the economy has been turned on its head in insurance regulation. That was appropriate in the market of 1945. It is not justified today.

<u>I therefore urge the committee to consider the following two steps.</u> First, not only should Congressional action pertaining to rate regulation be on the list of subjects for consideration in the SMART Act, it should be at the top of the list, bar none, since previous Congressional legislation helped to facilitate the current system, and since price controls substantially impact

interstate commerce. Second, Congress should consider modernizing its oversight of insurance by establishing a national policy which effectively preempts the inappropriate and ineffective practice whereby states attempt to provide availability and affordability of auto and home insurance through price controls.

Congress's regulatory power over interstate commerce exists because in some situations the states cannot be expected to overcome political obstacles and collective action problems. This is a classic case. Price controls made sense at some point long ago, but they gained a political backing in the states which has far outlasted the policy rationale for the practice.

Many regulators from other states have told me over the years that they believe that price controls are ineffective and a poor use of government resources. But they must apply the laws on their books, and in many states price controls are a favorite political issue for state legislators. So regulators, some of whom would rather use their scarce budgets to regulate areas of insurance where consumers cannot help themselves, must bite their tongues and enforce government's judgment about proper prices for that of the free market.

Because of political considerations, the states are unlikely to address this issue through the NAIC. Even if the NAIC were inclined to support competitive regulation of personal auto and homeowners insurance, it is doubtful that this would have significant effect. State legislators, not regulators, pass the laws which require insurance departments to scrutinize and sign off on rate levels.

As a result, the prevailing national policy in favor of competition is turned on its head in a large and essential industry, for the wrong reasons, and with bad results. This situation directly implicates the Constitutional rationale for the Commerce Clause: Congress is the only body which is institutionally designed and empowered to step in and solve thorny collective action problems which threaten the smooth functioning of interstate commerce.

Conclusion

Insurance is a product crucial to the well-being of our society. Individuals and families stricken by a loss rely on the protection provided by insurance to keep them off welfare, and the economy as a whole relies on the presence of insurance coverage to support risk-taking and spur growth. The product is so infused with the public good that it should be, and is, a heavily regulated enterprise. State regulation has provided essential oversight of the industry, and thus great service to the common good, for many decades.

I have not been an advocate of federal chartering of insurers. My strong preference has always been for retaining the primacy of state regulation if feasible. I believe, however, that the presence of price controls in the personal auto and homeowners marketplace badly undermines this goal. As I will briefly discuss below, that is why I feel so strongly and have spoken so bluntly about price controls today.

I believe that state rate regulation is presumptively unnecessary. It does not produce the results for which it is used today -- affordability and availability of product. Instead, it restricts supply, distorts the market, and harms consumers.

Furthermore, rate regulation has at least two more extremely harmful, and very practical, results. First, as discussed above, it diverts resources from the necessary solvency, market conduct, forms, and consumer complaints work that free market forces cannot regulate, and that the states must perform for the protection of consumers.

And secondly, price controls needlessly antagonize property-casualty carriers, who are forced to live under a punitive regulatory regime that no other competitive industry faces. Property-casualty carriers are natural allies of state regulation in the political arena: Their products are attuned to local markets since they must react to the different loss climates driven by factors particular to individual states, like weather and tort law. But more and more property-casualty insurers, including many previous staunch supporters of state regulation, are openly supporting a federal charter in Congress. This is a shame for supporters of state regulation.

I would like to conclude by expressing my gratitude to Chairman Baker for his outspoken support of competitive markets in property and casualty insurance, particularly in the personal automobile and homeowners lines. The issue of Congressional action with respect to state price controls is often described as the most politically difficult of all the titles under consideration in the SMART Act. But Chairman Baker has steadfastly maintained that, despite the political obstacles, addressing the anti-competitive practice of price controls must remain prominently on the subcommittee's agenda. Both he and Chairman Oxley should be commended for their clear thinking and political courage on this subject.

Thank you for your consideration and the privilege and honor of testifying before you today. I will of course be pleased to answer any questions from the committee.