

**Testimony of
Progressive Casualty Insurance Company**

**Before the
Subcommittee on Capital Markets, Insurance, and
Government Sponsored Enterprises**

**Committee on Financial Services in the United States House
of
Representatives**

**Reforming Insurance Regulation - Making the Marketplace
More Competitive for Consumers**

November 5, 2003

Good afternoon Chairman Baker, Ranking Member Kanjorski, and Members of the Subcommittee. My name is John Fitts, Deputy General Counsel of Progressive Casualty Insurance Company and I am pleased to have the opportunity to provide Progressive's viewpoint on insurance regulation and its impact on competition at today's hearing.

Progressive Casualty Insurance Company and its affiliated and subsidiary companies comprise collectively the third largest private passenger automobile insurer in the nation (Progressive) and the largest writer of auto insurance through independent agents. Progressive offers competitive rates for all risks and provides claim and policyholder services 24 hours a day, 365 days a year. We market insurance by phone, through more than 40,000 independent insurance agencies, and were the first to sell auto insurance over the Internet.

Progressive was also the first company to offer immediate response claims service, provide comparison rates from competitors and experiment with pricing insurance based upon when and where a person drives. With more than nine million customers, Progressive is committed to using the latest technology and innovation to reduce costs and improve customer experience. More information about Progressive can be found at progressive.com.

There is common acceptance by all stakeholders that the current insurance regulatory system needs to be reformed. Beyond that, opinions diverge with respect to the best way to approach this task. While many insurers are absolutely committed to state regulation of insurance, others have already concluded or are coming to the conclusion that some type of federal involvement is necessary to achieve regulatory modernization.

Progressive agrees that insurance regulatory reform is necessary and in the best interest of all stakeholders. We believe that the best regulatory model:

- Encourages competition, availability, and innovation in product design;
- Eliminates multiple layers of regulation;
- Facilitates the use of pricing and underwriting practices as long as they are fair and actuarially supported;
- Provides speed to market so that forms and rates for new and existing products can be used within reasonable time frames;
- Preserves the existing post-assessment solvency funds system and its fiscal stability;
- Provide expeditious company and producer licensing processes with consistency, uniformity, and flexibility;
- Permits companies to enter and leave markets without undue interference, cost or delays;
- Identifies and eliminates outdated regulatory requirements that no longer serve valid regulatory objectives;
- Provides flexibility that allows insurers to innovate and compete effectively against new rivals in the rapidly converging financial services industry;
- Eliminates regulatory variance in areas where there is no compelling need for difference;
- Is administered by regulators who are professional, knowledgeable about the industry, and capable of effectively balancing the interests of consumers and insurers; and
- Provides regulation that is consistent, sensible, reliable, and in accordance with law.

A regulatory system with these attributes will foster competition and make reasonably and accurately priced insurance available to more consumers. It will also encourage capital investment and promote a healthy insurance market. This can only benefit consumers.

In this statement, Progressive will discuss the impact of the current regulatory system on its business operations, provide its views on the ability of the state regulatory system to bring about meaningful reform, comment on the various federal solutions under consideration, and provide its current thinking on the best way to accomplish regulatory reform.

Impact on Progressive

Probably more than most industries, insurance is a pass through business. The costs Progressive incurs to provide its product (indemnification for covered losses) comprise the overwhelming majority of each dollar of premium written. These costs include claims payments and loss adjustment expenses, policy acquisition costs, and general administrative expenses, including costs associated with regulatory compliance. Since lower prices make Progressive more competitive, we work hard to manage costs in every aspect of our business.

As a national group of insurance companies, Progressive is subject to regulations in all 48 states where it does business. Progressive spends tens of thousands of man-hours and millions of dollars annually on compliance related activities and is keenly aware of the tremendous costs associated with developing the infrastructure, systems, and procedures necessary to assure compliance with the mosaic of state insurance regulations applicable to national insurance providers.

A significant percentage of our compliance costs are necessitated by the need to address the differences in rules that apply from state to state. Every difference between states requires a distinct compliance response. When these responses are applied to the totality of insurance regulation across 48 states and, at times, multiple product lines, the appeal of, and need for, uniformity become compelling. Simply stated, uniformity enhances efficiency and reduces cost. While some variance is necessary to respond to local conditions, there are many areas where there is no compelling need for regulation to vary by state.

Progressive is also subject to the various state rules with respect to rate and form approval. These laws vary both in form and application. While the approval process operates efficiently in some states, in others unreasonable delays impact our ability to charge adequate rates or offer new or revised policy forms. In some states the approval process is highly politicized. At times this can lead to unreasonable rate suppression that in turn can ultimately result in availability problems. Getting accurately priced products to the market on a timely basis is vitally important to consumers, regulators, and Progressive, but is not always possible under the rate and form approval process in place in some states.

Progressive is also subject to having its market conduct and finances examined regularly by the various states where it does business. A recent GAO study has documented a number of shortcomings in the current market conduct examination process. Some reduce the consumer protection value of market conduct exams while others result in an inefficient and redundant process. Neither outcome is in the best interest of Progressive or our customers.

Ironically, Progressive believes that the current system provides it with a competitive advantage. At many levels, the cost of compliance is the same whether an insurer writes 100 or 100,000 policies in a given state. While large groups of companies like Progressive can spread those costs over a broad customer base, smaller companies, or companies seeking to enter a new market do not have the same economies of scale and some have a difficult time building the infrastructure necessary to ensure compliance on a multi-state basis.

Nevertheless, the costs associated with insurance regulation exceed what is necessary to protect the interests of consumers properly and addressing this problem is clearly in the best interest of Progressive and its customers. Therefore, Progressive wholeheartedly supports reforms that will reduce the cost of regulatory compliance for all insurers and provide better speed to market without sacrificing consumer protection.

State Regulation

The state regulatory system generally performs a number of useful functions very well. It is responsive to local market conditions and plays an important role ensuring that consumers receive the coverage they need from solvent insurers that settle covered claims on a timely basis for fair and reasonable amounts. When disputes arise between insurers and their policyholders state insurance departments often effectively intervene to resolve them.

There are, however, inconsistencies in the nature and quality of regulation on a state-to-state basis and, to the extent that regulatory modernization embodies notions of uniformity and consistency, these objectives have proven to be very difficult to achieve in the current state based system. Despite the commitment to regulatory modernization by the NAIC leadership and many other regulators, the implementation of this agenda requires the commitment of each state insurance department and state legislature. With so many interested parties, achieving regulatory modernization is inherently cumbersome. It is extraordinary difficult, if not impossible, to pass identical laws and implement uniform regulatory policy and procedures in every state.

The recent experiences with the NAIC Model Producer Licensing Act (MPLA) and the state response to regulating insurance credit scoring are two examples of the difficulties associated with obtaining uniform regulation within the existing state system. Although most states have passed producer licensing laws that have been deemed MPLA compliant by the NAIC, there are still numerous differences in the state requirements for licensure including the application forms, background checks and finger print requirements, and rules associated with non resident licensing to name a few. Moreover, archaic paper intensive procedures still abound. In the final analysis, despite the intent behind the MPLA, Progressive has not been able to achieve meaningful reductions in its administrative costs relating to producer licensing compliance nor has it realized the efficiencies it had hoped to achieve in the operation of its direct call centers.

Over the last few years, many states have promulgated regulations, issued bulletins or passed laws regulating the use of credit information in rating and underwriting. The result has been a patchwork of differing regulation on issues such as the definition of adverse action, disclosure requirements, adverse action notice requirements, the types of credit information that can be used, the treatment of no hits and thin files, the treatment of renewals etc. Even with the NCOIL model act available as a national standard, few states adopted that model act without some modification and many states opted for a state specific bill.

During the last several years the NAIC has devoted substantial time and effort to the issue of regulatory modernization. To that end, the NAIC recently issued a document entitled "*A Reinforced Commitment: Insurance Regulatory Modernization Plan.*" This document does a good job of identifying those areas where regulatory reform is necessary, provides principles and goals that are consistent with meaningful reform, and provides action plans to achieve them. While we are concerned about the apparent lack of commitment to address speed to market issues in personal lines and feel that some of the time deadlines are too long, if the NAIC were able to implement the reforms discussed in the Reinforced Commitment document, it would be a tremendous accomplishment.

Progressive is, however, skeptical that the stated objectives of the NAIC can be accomplished under the current system where, once the deliberations at the NAIC have ended, each state is free to ignore the NAIC's recommendations or pursue a different regulatory policy. We believe that ultimately the NAIC would be more likely to succeed in its reinforced commitment if it had active federal support.

Progressive's views on the ability of the state regulatory system to reform itself should not be interpreted as an indictment of state regulation. We support state regulation and have tremendous respect for the regulators we work with on a daily basis. The Progressive Corporation and its largest subsidiary, Progressive Casualty Insurance Company, are fortunate to be domiciled in the State of Ohio. Director Ann Womer Benjamin and her predecessors have assembled a highly competent and professional staff who fairly balance the interests of consumers and insurers when discharging the regulatory powers of the Ohio Department of Insurance

In addition, we do not question the personal commitment of Commissioner Pickens and the leadership of the NAIC. The problem with the implementation of meaningful reform is systemic--primarily relying on 50 state legislators to act uniformly-- and, in our judgment, cannot be effectively addressed under the current state system.

Federal Options

Progressive is not, however, a current proponent of an optional federal charter nor the federalization of insurance regulation. Creating a separate insurance regulatory system or dismantling the state system in favor of a federal system would be expensive, disruptive, and seemingly unnecessary to achieve the goals of regulatory modernization.

On first impression, the concept of a federal charter with companies subject to one national regulator might seem appealing. However, this appeal may be deceptively simple. In the private passenger automobile market, there are significant geographical variances in the law and coverages required. This creates a complexity that would make it extremely difficult for a national regulator to understand local market conditions and successfully respond to insurer or consumer concerns. In a dual regulatory system, there would undoubtedly be consumer confusion that would be exacerbated for consumers insured by both state and federally chartered companies. Moreover, the tension between state and federal regulation could ultimately lead to an unlevel competitive playing field. Lastly, bad regulatory policy would potentially have disastrous implications when applied on a national basis.

The recently introduced Insurance Consumer Protection Act (S1373) proposes to repeal the McCarran-Ferguson Act and create a "Federal Insurance Commission" housed within the Department of Commerce which would act as the sole regulator of all interstate insurers offering property and casualty and life insurance. The Commission would have authority over rate and forms, and be responsible for licensing, examination, solvency, market conduct, and accounting standards.

This sweeping proposal for reform is, in our opinion, unnecessary and unlikely to accomplish an effective regulation of the insurance industry. The task of dismantling or assimilating some or all of the current state regulatory system within a new federal system would be monumental. The ability of insurance regulators to respond to local market conditions and consumer complaints will most likely be compromised. Moreover, we are concerned that the broad powers proposed to be granted to the federal regulators would reduce the efficient impact of market forces on the rate setting process. This would not be a good outcome for American consumers.

A more effective use of federal powers to facilitate regulatory modernization is an approach that builds on the strength of the state regulatory system while providing a means to implement

uniformity and consistency in every state--Congressional promulgation of uniform national standards of regulation to be enforced by the existing state regulatory system. In theory, effective federal standards would require states to implement reforms that could bring uniformity, consistency and efficiency to insurance regulation. Federal standards could be applied in many areas of insurance regulation where there is no compelling reason for state-by-state regulatory variance.

Given the current practical barriers to the delivery of uniform and consistent state regulation, use of federally enacted national standards could enhance the process and in fact, be welcomed by many who seek to preserve state regulation. However, federal standards that merely constitute a floor over which states may enact additional regulation (such as the privacy provisions of Gramm-Leach-Bliley) leads to an inefficient mosaic of varying and inconsistent regulations. To be effective, federal standards should preempt the field and be subject to interpretation by the federal courts. In this form, Progressive would support reasonable federal standards.

Progressive's Assessment of the Best Option

From Progressive's perspective, the approach with the best chance of bringing about meaningful reform is the use of reasoned preemptive federal standards. While we believe that such federal standards can be applied in many areas, the approach is novel and should initially be limited to a few targeted issues. Specifically, we would encourage the Congress to work with interested parties on the development of a federal standards bill that addresses producer and company licensing, market conduct examinations, and speed to market.

The components of a federal standards bill need not be debated today. Needless to say, many interested parties (insurers, agents, the NAIC, NCOIL, and consumers) should participate in the process so that any federal standards bill would achieve the desired reforms without unintended negative consequences. From our perspective, federal standards should accomplish the following general objectives:

Producer and Company Licensing: procedures should be streamlined through the use of uniform applications, technology, and reliance on home state regulation.

Speed to Market: in a competitive market, rate regulation should be on a use and file basis. Rates could not be excessive, inadequate or unfairly discriminatory. Policy forms would be subject to a thirty-day prior approval.

Market Conduct: without sacrificing consumer protections, the market conduct examination process should be streamlined. Home states should take primary responsibility for market conduct review with non-domiciliary state examinations targeted on specific areas of concern. Uniform examination procedures should be adopted and the self-evaluative audit privilege should be recognized.

Federal standards are a tool that can be used broadly to encourage regulatory reform in a number of other areas. This would include issues such as privacy, e-commerce, telemarketing, records retention, policy notices, and countless others. With federal standards there are tremendous opportunities to reduce costs and enhance competition without sacrificing consumer protection.

Conclusion

Change in the insurance regulatory environment is both necessary and inevitable. The alternative is the continued imposition of needless costs that impede the ability of American insurers to compete in the global market and constitute a financial burden on American consumers. We hope that Congress will continue to act as a positive force in the regulatory reform process moving deliberately and

cautiously to ensure that any federal involvement clearly meets the interests of all stakeholders without creating unintended negative consequences.

United States House of Representatives
Committee on Financial Services

“TRUTH IN TESTIMONY” DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name: John T. Fitts	2. Organization or organizations you are representing: Progressive Casualty Insurance Company
3. Business Address and telephone number: 300 North Commons Blvd. Mayfield Village, OH 44143 (440) 395-0243	
4. Have <u>you</u> received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2000 related to the subject on which you have been invited to testify? Yes No X	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2000 related to the subject on which you have been invited to testify? Yes No X
6. If you answered yes to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets. 	
7. Signature: Original Signed by John T. Fitts	

Please attach a copy of this form to your written testimony