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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY  
EXPECTED AT 9:30 AM  
MARCH 4, 1986

STATEMENT OF  
LAWRENCE H. THOMPSON  
CHIEF ECONOMIST  
BEFORE THE  
COMMITTEE ON COMMERCE, SCIENCE AND TECHNOLOGY  
UNITED STATES SENATE  
MARCH 4, 1986



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Mr. Chairman and Members of the Committee:

I am pleased to appear here today to assist you in your consideration of current problems in the availability of insurance. I understand that the Committee believes GAO can supply some useful background information for your current deliberations by describing briefly our 1979 report entitled "Issues and Needed Improvements in State Regulation of the Insurance Business (PAD-79-72)." I am accompanied by Mr. Mark Nadel, the principal author of that study.

In our 1979 study we reviewed the background, purposes, and need for insurance regulation; the resources and workloads of state insurance departments; and the state insurance department surveillance of the financial condition and trade practices of insurance companies. We also conducted a more detailed analysis of the regulatory issues surrounding automobile insurance, such as risk classification, unfair discrimination, price regulation, and insurance availability.

Our study was based on three kinds of data. We sent a questionnaire to all state insurance departments of which 45 replied. We performed detailed fieldwork in the insurance departments of 17 states. And, we analyzed data from insurance industry sources.

While much of our report focused on personal automobile insurance, this morning I would like to summarize our findings in two, more generic areas:

--insurance availability, and

--trade practice regulation.

One of the issues of insurance availability that was of particular concern when we did our report was redlining--the arbitrary denial of insurance to everyone living in a particular neighborhood. We found that most states did not either systematically collect data or conduct special studies to determine if redlining exists.

Underwriting practices also affect insurance availability. While classification categories, such as territorial ratings, are based on explicit and objective categories, underwriting tends to be more subjective, and may lead to consumers' being denied essential insurance because of unsubstantiated judgments. At the time we did our study, questions had been raised about the propriety of certain underwriting guidelines. For example, at that time some underwriting manuals listed as "objectionable" such occupations as painter, automobile dealer, and waiter.

Only 26 percent of state insurance departments responding to our questionnaire reported that they had the authority to forbid the use of particular guidelines. Few state departments even reviewed or collected underwriting guidelines used by insurance companies at that time. Generally, departments collected only some manuals or portions of manuals.

Furthermore, we found that most states provided only limited protection to consumers who had adverse underwriting decisions. Individuals who are rejected for standard automobile insurance can usually obtain insurance through assigned risk plans, but may find that the coverage available there is severely limited.

With regard to consumer protection generally, we found that insurance departments lacked sufficient information to regulate effectively. While we did not examine all the data collection and analysis activities of state insurance departments, we found deficiencies in every one that we did review.

We examined in particular whether insurance departments were responsive to consumer complaints, and whether departments were able to find out whether particular companies or trade practices were creating problems for consumers.

Most of the departments we visited followed up on consumer complaints, but had only limited authority to do anything about them. Most state insurance departments did not have systematic complaint handling procedures whereby complaints were coded, analyzed, and used in the examination and regulation of insurance companies. Complaints could reveal a pattern of abuses by insurers or agents, but such information was generally not developed.

While most insurance departments undertook market conduct examinations which review trade practices, based on the examination reports that we reviewed, the market conduct examination process needed considerable improvements.

In short, we found in 1979 that the insurance regulatory process needed more and better information, and more systematic procedures, to assure that consumers received adequate protection.

In our review of automobile insurance regulation, we focused on two closely related issues: risk classification and price regulation. Risk classification is the division of risks by territories, and the use of age, sex, and marital status as indicators of risk. The structure of risk classification systems was at the time--and continues to be--a major issue in automobile insurance regulation. We assessed the extent to which the states

have evaluated whether these plans constitute unfair discrimination, and found, in general that the states were not conducting adequate analyses to make that determination. With regard to price regulation, we found that there was almost no difference, on the average, in automobile insurance cost between states that require prior approval of insurance rates and those that do not. In the area of insurance prices, we concluded that less regulation was warranted.

The General Accounting Office has several studies now underway which may be of interest to this committee. They are listed in the attachment to my statement and include:

- o an examination of the resources currently available to the state insurance departments of three states;
- o a study of problems in the availability of environmental restoration insurance for motor carriers;
- o a series of studies of problems in medical malpractice insurance and potential approaches to solving them;
- o a review of the effects of regulation on the cost and availability of automobile insurance; and

- o a review of the effect of competitive rate making for workers' compensation insurance.

Each of these studies is in response to a Congressional request and they are being executed in different parts of GAO. If the committee is interested in learning more about any one of them, I would be happy to work with the committee staff to arrange a meeting with the people knowledgeable about that particular job.

This concludes my prepared statement. Mr. Nadel and I would be happy to answer any questions you may have.

MARCH 4, 1986

CURRENT INSURANCE RELATED STUDIES  
AT THE GENERAL ACCOUNTING OFFICE

Insurance Department Resources

The Chairman of the Subcommittee on Commerce, Transportation, and Tourism of the House Energy and Commerce Committee asked us to review the resources available in the insurance departments of Ohio, Delaware, and North Carolina. We intend to compare what we find in 1986 to what we found in our 1979 study. This study is just starting; we expect to report our findings in late summer.

Environmental Insurance for Motor Carriers

The Chairman of the Subcommittee on Surface Transportation of the House Committee on Public Works and Transportation asked us to look into the availability of environmental restoration insurance for motor carriers. As part of the this study, we are surveying insurance companies that write environmental restoration insurance and examining the practices of state assigned risk plans with respect to this form of insurance. We anticipate having a briefing report on this work in May.

Medical Malpractice

The Chairman of the Senate Special Committee on Aging and Congressman John Porter requested a series of studies on medical malpractice issues. The first of the studies was released yesterday. It summarizes the perceptions of national organizations about current problems, proposed solutions, and the role of the federal government in dealing with malpractice problems. It also describes some of the alternatives to the tort liability system that have been proposed as ways of dealing with medical malpractice.

The second study, which we expect to complete in July, will focus on the costs of medical malpractice insurance to hospitals and doctors. The third study, which is scheduled for completion in October, will examine the current malpractice situation in six states regarding the frequency and severity of malpractice claims and their impact on the cost and availability of insurance. The fourth study will look at characteristics of malpractice claims closed in 1984, including the size of the loss sustained, the size of the insurance settlement, and the time required to settle the claim. Current plans are to complete this study in November. Finally, we plan to issue a "capping report" in March of 1987 pulling together the information contained in each of the first



four studies and will include matters for consideration by the Congress, as appropriate.

#### Automobile Insurance

At the request of the Chairman of the Subcommittee on Commerce, Transportation and Tourism of the House Energy and Commerce Committee (subsequently joined by the Chairman of the House Committee on the Judiciary), we are reviewing the effect that competitive rate making has had on the availability and affordability of automobile insurance. We are also examining the compatibility between competition and nondiscrimination in automobile insurance rating plans. This report should be released in May.

#### Workers' Compensation

At the request of the Chairman of the Subcommittee on Entrepreneurship and Special Problems Facing Small Business of the Senate Committee on Small Business, we are examining the experiences of states that have recently instituted competitive rate making for workers' compensation insurance. One of the concerns we are looking into is the effect of the change on small business. We expect to report on this work in the middle of the summer.